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PHASE II INCREMENTAL PRICING OF NATURAL GAS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ENERGY AND POWER

OF THE

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

H. Res. 655

RESOLUTION DISAPPROVING THE PROPOSED RULE UNDER SECTION 202 OF THE NATURAL GAS POLICY ACT OF 1978 (RELATING TO INCREMENTAL PRICING) TRANSMITTED TO THE CONGRESS ON MAY 6, 1980

APRIL 3 AND MAY 6, 1980

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PHASE II INCREMENTAL PRICING OF NATURAL GAS

THURSDAY, APRIL 3, 1980

House of Representatives,
Subcommittee on Energy and Power,
Committee on Interstate and Foreign Commerce,
Washington, D.C.

The subcommittee met, at 10 a.m., pursuant to notice, in room 2123, Rayburn House Office Building, Hon. John D. Dingell, chairman, presiding.

Mr. Dingell. The subcommittee will come to order. Today's hearing concerns the subject of incremental pricing. Incremental pricing is one of the very important elements of the compromise that was forged during the 95th Congress which resulted in the enactment of the Natural Gas Policy Act of 1978. The Chair wants that to be clear in the mind of everybody present.

The act provides for the phased decontrol of wellhead prices of natural gas. Incremental pricing allocates a portion of the cost of new gas supplies to industrial users. It was put into the Natural Gas Policy Act of 1978 as a market ordering device.

In this manner, incremental pricing was designed by Congress to restrain the prices paid by pipelines for natural gas supplies, particularly after deregulation, and to protect residential consumers from the higher prices resulting from deregulation. Again, I reiterate it was to be a market ordering mechanism.

Incremental pricing is implemented in phases. Phase I, which started on January 1, applies only to large industrial facilities using natural gas as a boiler fuel and sets a ceiling price for these users at the price of high sulfur No. 6 fuel oil. Phase I was mandated by the Natural Gas Policy Act and is not subject to congressional review.

Phase II requires the Commission to decide what other industrial facilities should be included in the incremental pricing program. The Commission's preliminary decision for phase II was announced on March 20. On March 25, the Commission issued a summary of its preliminary decision, which was mailed last week to our witnesses.

The Commission's phase II preliminary decision includes all industrial users not exempted by the statute in the incremental pricing program, exempts the first 300 Mcf used each day and sets the ceiling price at the price of high sulfur No. 6 fuel oil. This preliminary decision differs substantially from the proposal issued by the Commission last fall which caused considerable controversy.

The final phase II regulation must be submitted to Congress by May 9, and will become effective unless it is disapproved by either House.

The controversy surrounding incremental pricing may be reduced to a single issue. How should the costs associated with the Natural Gas Policy Act and the deregulation of natural gas prices at the wellhead be allocated between residential and industrial customers?

Residential rates for natural gas have always been higher than industrial rates. Comparing the first and third quarters of 1979, when the wellhead prices for natural gas were higher because of the Natural Gas Policy Act but incremental pricing had not yet been put into effect, the difference between the average rate to industrial and residential customers increased from 57 cents to $1.27.

During this period, residential rates increased 98 cents, while industrial rates increased only 28 cents. At the end of the third quarter of 1979, residential users paid an average of $3.59 per Mcf, while industrial users paid an average of $2.32 per Mcf. Not surprisingly, during this same period industrial gas consumption increased 15 percent, while residential consumption remained constant.

The Natural Gas Policy Act reflects a policy decision to close the gap between industrial and residential rates. The perception was that large industrial customers are the first to benefit from new supplies of decontrolled gas and that they should begin to pay the true costs of the extra supplies that they received.

Indeed, the premise for deregulating natural gas prices was that to price domestic fossil fuels below the cost of imported energy would disguise the real replacement cost of these resources and would encourage waste.

The record of the hearings and deliberations of this committee in conference are quite replete with references to that matter. This hearing will seek to determine whether the Commission's phase II decision requires industrial users to pay more than their fair share of the costs of natural gas and to inquire into other matters that are relevant to the decisions that will be made by the Congress as to whether or not the Congress should approve or disapprove the phase II decision.

The Chair would like to observe that I have at this time arrived at no decision as to whether or not it will be necessary for us to support or to legislatively veto the Commission's action on phase II. The Chair would like all to know, however, that I think it is premature for anyone to make a hard judgment as to what actions Congress should take on the Commission's action on phase II.

I will be happy to hear our witnesses within the framework of those comments. The Chair is very pleased to recognize Mr. Brown, our senior minority member, for any comments he may have.

Mr. BROWN. Thank you, Mr. Chairman. The issue for consideration today, incremental pricing, was embraced as part of an agreement which achieved a majority for the Natural Gas Policy Act of 1978 after a long and extended debate not only in the subcommittee and the full committee, but the House, the Senate, and the conference, the longest running conference up to that point I think that has been in existence since I have been in the Congress.

But, not all of us in the Congress or on this subcommittee were party to that agreement because the Natural Gas Policy Act was finally passed out of the conference by the narrowest of majorities and, therefore, has been a controversial piece of legislation since, at least in the minds of some of us.

At a time when we have rising costs and economic difficulties in our country and a decline in competitiveness abroad, the situation in which we find ourselves with the pricing of natural gas does have some bearing on the ability of industries to be competitive not only within this country where that pricing of energy may vary because of the legislative thrust of the Natural Gas Policy Act, but also where industries in this country may have difficulty being competitive with industries in other parts of the world.

If that situation is exacerbated, then we face, in effect, the possibility that the industry may be disadvantaged to the extent that the people who would otherwise be residential users in the service area of that industry may have an extra burden because the industry may not be successful in maintaining itself as a provider of incomes to the private community and the private community, of course, winds up stuck with the gas bill, whether it is incrementally priced to industry or whether it is incrementally priced to the private consumer.

So, the problem is not a simple one. It is a fairly complicated one with reference not only to regional differences within the United States, but also with reference to the U.S. relationship abroad and with reference to the relationships between the kinds of fuels as well as the relationships between industry and the individual home consumer.

It is worthy I think of our having hearings. It is also worthy of our consideration of revising policy by the Congress in an area where a policy agreement was only achieved by the narrowest of margins.

Mr. DINGELL. The Chair is happy to announce that our first panel will be Mr. S. M. Salvino, president, Peoples Energy Corp.; Mr. E. D. Crittenden, vice president, Hercules, Inc.; Mr. Andrew S. Merrels, director of energy purchases and hydrocarbon ventures, Owens-Corning Fiberglas Corp.

The Chair also understands you will be joined by Mr. Gordon Gooch, Esq. and Mr. Henry E. Miller, assistant vice president, Corporate Operating Affairs, Armco, Inc., and Mr. Edward J. Grenier, Esq.

We will recognize first Mr. Salvino and then Mr. Crittenden. Mr. Salvino, you may proceed.

STATEMENTS OF S. MARK SALVINO, PRESIDENT, PEOPLES ENERGY CORP., ON BEHALF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY JAN VLCEK, COUNSEL; E. D. CRITTENDEN, ON BEHALF OF PETROCHEMICAL ENERGY GROUP, ACCOMPANIED BY GORDON GOOCH, GENERAL COUNSEL; AND ANDREW S. MERRELS, ON BEHALF OF THE PROCESS GAS CONSUMERS GROUP, AMERICAN IRON AND STEEL INSTITUTE, AND GEORGIA INDUSTRIAL GAS GROUP, ACCOMPANIED BY HENRY E. MILLER, ASSISTANT VICE PRESIDENT, CORPORATE OPERATING AFFAIRS, ARMCO, INC., AND EDWARD J. GRENIER, JR., COUNSEL

Mr. SALVINO. Mr. Chairman and members of the subcommittee, my name is Mark Salvino, and I am president of Peoples Energy Corp. I appear today as a witness on behalf of the Natural Resources Committee of the Chamber of Commerce of the United States and its 96,000 members. With me is Jan Vlcek, of Gardner, Carton & Douglas, counsel to the Peoples Energy Corp.

The U.S. Chamber is the largest business federation in the world. Most of the 88,000 company members of the chamber are small businesses, many of whom will be severely and adversely affected by the incremental pricing of natural gas.

I ask that my written statement be included in the record in full, also the statement filed with FERC regarding the rule 2 hearings on behalf of some 130 associations and industrial users of natural gas. [See p. 16.]

Mr. DINGELL. Without objection, your full statement will be inserted in the record. [See p. 6.]

Mr. SALVINO. We appreciate the opportunity to appear before you today to discuss incremental pricing under title II of the Natural Gas Policy Act and the Federal Energy Regulatory Commission's recent actions implementing that title.

It should be recognized that the Chamber of Commerce and the Peoples Energy Corp. opposed the enactment of the Natural Gas Policy Act of 1978 because, among other things, we recognized the inherent problems with title II of the act. Consistent with our position, we fully support the adoption of H.R. 5862 introduced by Congressmen Preyer and Stockman to repeal title II of the Natural Gas Policy Act.

When the Congress was considering the Natural Gas Policy Act of 1978, we were living in an entirely different energy and economic world. To cite several of the more important changes that have taken place since enactment of the NGPA:

First, OPEC has increased imported oil prices by over 100 percent in the past year.

Second, the United States is experiencing severe inflation, dramatically high interest rates and faces an almost certain recession.

Third, the severe balance-of-payments problems facing the Nation make exports absolutely essential in order to maintain some value in the U.S. dollar.

Fourth, worldwide competition for export markets and its implication for domestic employment is growing daily, as exemplified by the automobile marketing problems of U.S. manufacturers. The entirely different supply and demand scenario of natural gas in the United States, wherein significant conservation already experienced has reduced demand while supply has improved considerably.

Clearly these changes could not have been contemplated when the NGPA of 1978 was under consideration by the Congress, particularly their significance and occurrence in such a short period of time.

To the extent that increased energy costs cannot be passed through by industrial concerns, income for reinvestment is reduced and our capital formation problems intensified.

Accepting that we are faced with an entirely different set of energy and economic conditions, a review of the major objectives of the incremental pricing legislation in light thereof suggests that we may be protecting the residential and small commerical users of interstate natural gas, at the expense of users of higher priced fuels. Residential natural gas users represent less than 50 percent of the Nation's heating energy users and the absolute gap between heating with gas and oil has increased since 1978 and will undoubtedly increase more by 1985, if OPEC persists in increasing imported oil prices. At what level does protection become unreasonable and a source of serious concern to the majority, the non-natural gas residential users who indirectly provide the subsidy?

We, in fact, have more than enough market ordering mechanisms in place, when one considers the significant influence of the gas distribution companies on their pipeline suppliers gas purchasing practices, the regulatory impact of State public utility commissions in influencing the pricing by gas distribution companies, the consumer groups opposing expensive supply additions or supply projects.

Finally, the Federal Energy Regulatory Commission, in its regulation of rate design, rate of return, and the movement of natural gas through jurisdictional pipelines. We believe the continuation of incremental pricing for market ordering purposes suggests regulatory overkill.

In summary, it seems like this is a poor time to be considering the addition of any burden on American industry, no matter how small when recession is impending and exporting of U.S. products is essential to the health of our economy. What we need, and I believe the administration and Congress share that view, are ways to improve the competitiveness of U.S. industry, and passage of phase 2 of incremental pricing is a step in the wrong direction.

Thank you.

[Testimony resumes on p. 24.]

[Mr. Salvino's prepared statement and attachment follow:]

STATEMENT
on the
RULE REQUIRED UNDER SECTION 206 OF THE NATURAL GAS POLICY ACT OF 1978
before the
ENERGY AND POWER SUBCOMMITTEE
of the
INTERSTATE AND FOREIGN COMMERCE COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
S. M. SALVINO

APRIL 3, 1980

Mr. Chairman, members of the Committee:

My name is Mark Salvino and I am the President of Peoples Energy Corporation. I appear today on behalf of the Chamber of Commerce of the United States and its 96,000 members. I am a member of the U.S. Chamber's Natural Resources Committee. The U.S. Chamber is the largest business federation in the world. Most of its company members are small businesses, many of whom will be severely and adversely affected by the incremental pricing of natural gas.

Peoples Energy Corporation is the parent company of Natural Gas Pipeline Company of America, a major interstate natural gas pipeline; Peoples Gas Light and Coke Company, a natural gas distribution company serving approximately 890,000 residential, industrial and commercial customers within the city of Chicago; and North Shore Gas Company, a local distribution company serving primarily residences, located north of Chicago.

We appreciate the opportunity to appear before you to discuss the Federal Energy Regulatory Commission's (FERC) preliminary actions implementing the second phase of incremental pricing as set out in the FERC press release dated March 26, 1980. The U. S. Chamber and Peoples Energy Corporation fully participated in the rulemaking hearings. We also opposed the enactment of the Natural Gas Policy Act of 1978 (NGPA) because - among other reasons - we recognized inherent problems with Title II.

Consistent with our prior position, we fully support the adoption of H.R.5862, introduced by Congressmen Preyer and Stockman, to repeal Title II of the Natural Gas Policy Act. This bill has more than 80 co-sponsors, a number of whom sit on this Subcommittee.

FERC has not yet issued its final rules implementing incremental pricing but in a press release outlined its tentative decision and instructed its staff to draft an appropriate order. To understand the problems with incremental pricing, we will discuss the points brought out in this press release and the changes that have occurred in energy pricing since passage of the NGPA.

Title II, of the NGPA, phases in incremental pricing; first for large industrial boiler fuel facilities (Section 201); and second, to all other industrial facilities (Section 202). These sections should not be treated separately because a rule under Section 202 is merely an amendment to the rule under Section 201.

An expansion of incremental pricing to all industrial facilities is adverse to our national policy of reducing oil imports. Our experience with Phase I leads us to conclude that such an expansion is also poor national policy.

When Congress was considering the Natural Gas Policy Act of 1978, we were living in a different energy world. In November, 1978, the average No. 6 high sulphur oil price was $1.73 per MMBtu. The current price is $3.50 per MMBtu, more than double.

One of the items submitted to Congress during its deliberations on NGPA was a September 12, 1978 letter from then Secretary of Energy, James Schlesinger, a document entitled "The Most Frequently Asked Questions About the Natural Gas Policy Act of 1978," setting forth arguments supporting enactment. In discussing the incremental pricing provisions of the bill, the Secretary of Energy cited an Energy Information Administration analysis which projected that under incremental pricing the average cost of natural gas to industrial users in 1985 would be $2.59 per MMBtu. According to FERC, the average cost of natural gas to industrial users in January, 1980, was $2.60 per MMBtu, already beyond the price projected for 1985.

The Department of Energy's February 8, 1980 filing with FERC on the proposed Section 202 rule projected that the price of gas to incrementally priced users under a No. 6 high sulphur fuel oil cap will be $4.63 per

MMBtu in 1985. For intrastate industrial users of natural gas, the estimated price will range between $5.43 and $5.78 per MMBtu (depending on whether the purchaser is direct or indirect). Thus, both the Department of Energy and FERC have concluded that the 1978 projections - upon which enactment of incremental pricing was predicated - are now inaccurate, if not moot.

One of the original purposes of incremental pricing was to serve as a "market ordering mechanism." Under this theory, higher prices would be passed to industrial users first who would pressure their suppliers to keep down the prices paid to producers. This concept has not worked. Again, both the Department of Energy and FERC have conceded that incremental pricing will not order the market. DOE so concluded in its February 8, 1980 submission to FERC. FERC, in its release of March 26, 1980 (No. FE-813 at page 16) states, "...the Commission accepts the view expressed in many comments stating that industrial end users who have little or no capability to switch to alternative fuels are in a relatively weak position to affect the prices that pipelines will pay for natural gas."

Another argument advanced supporting incremental pricing was that it would result in the protection of residential consumers from increases in the cost of natural gas. It has been argued that, historically, industrial users of natural gas have paid lower prices and, in effect, have been subsidized by residential consumers. To respond, it is important to establish first some of the basic principles of natural gas ratemaking. Without addressing the technical problems of natural gas rate design here is a brief explanation of natural gas rate structures. Industrial users consume large quantities of gas at a single location. The fixed cost of supplying them is relatively low on a unit volume basis because this cost can be spread to a larger volume of gas. The fixed cost of serving the residential user is be spread over the smaller volume of gas they consume. Any benefit to residential customers is predicated on the assumption that there will be no loss of load due to incremental pricing.

If the gas company loses industrial customers, all others must pay an additional share of the total fixed cost and their monthly bill must increase. FERC recognized this in their press release. Page 14 states, "...Title II in its legislative history evidences a Congressional intent that incremental pricing not be responsible for industrial load loss." I agree with the FERC conclusions and regret that to date under the rule of Section 201 (Phase I) there has been a reduction in industrial loads.

This committee should be aware that the threat of load loss is not a hypothetical argument for repeal. It is real. There have been load losses by interstate pipelines and local distribution companies under Phase I. Customers are switching from natural gas to alternate fuels. Northern

Illinois Gas Company has experienced a loss of 2.4 Bcf of industrial load under Phase I.

Some customers have switched from gas to coal, but a large number switched to oil. We are aware that Northern Natural Gas Company in the Midwest has identified at least twelve industrial facilities who will, because of incremental pricing, switch from natural gas to oil. Any policy which encourages switching from domestic gas to imported oil is clearly counterproductive. FERC and Congress attempted to structure incremental pricing so that users would not be forced to switch to oil under Phase I. There is no reason to believe the situation will be any different under rules of Phase II.

The Energy Information Administration (EIA) compiles and publishes the alternative fuel prices. Oil dealers can wait for the EIA publication and offer industrial customers No. 6 -- high sulphur residual oil -- at a lower price than the EIA published price. Of course, the lower priced fuel is preferred by customers. Natural gas distributors cannot compete with such "price cutting." The oil dealers are able to adjust their price at any time to attract new customers, even if for imported oil.

There is a specious argument that incremental pricing will not be inflationary because industry will not pass through the increased costs. The alternative to not passing through the price is a decline in profits (even losses) and reduced income for reinvestment. This situation intensifies problems already encountered with capital formation.

Another consideration is the effect of incremental pricing on our ability to compete in the international marketplace. We have not seen any analyses by DOE or FERC on this facet of the problem. Unknown are the impacts on the steel or automobile industries' abilities to compete with imports due the increased cost of natural gas. These issues must be examined.

Another international competitive factor that must be considered is the price of natural gas in Canada and Mexico. Neither nation prices natural gas so as to discriminate against industrial users. In fact, the price of natural gas to industrial users is substantially cheaper in both of these countries than in the United States. The average industrial gas rate in Toronto, Canada for 1979 was $1.90 per MMBtu, while in Detroit, the incremental price ceiling is $3.23 per MMBtu. Pricing of natural gas to industries is considered on a case by case basis in Monterrey, Mexico, where a steel plant is paying less than $0.50 per MMBtu. Incremental pricing creates an economic incentive for energy intensive industries to relocate outside of the United States, counterproductive and contrary to national policy.

A major concern is the regulatory burden imposed by incremental pricing. Any additional regulation or complication represents a hidden cost of incremental pricing. State regulatory bodies are burdened with insuring that local distribution company rates, which have historically been subject solely to state regulation, comply with the new federally imposed natural gas pricing scheme.

Incremental pricing fails to send the proper price signals to consumers of interstate natural gas. Industry has already recognized the increasing value of energy. The most recent Annual Report by DOE on the Industrial Energy Efficiency Program concluded, "In summation it may be stated that reported data reflects (sic) a growing trend of awareness and commitment to energy conservation in United States industry that has resulted in a decreased rate of growth in energy consumption during a period when industrial production has significantly increased." In its February 1, 1980 interim report on U.S. Energy Conservation Strategy, the Office of the Assistant Secretary for Conservation and Solar Energy recognized that the conservation in the residential and commercial sectors has grown slowly. Since the industrial community is aware of the need to conserve, we see no reason to arbitrarily increase their prices.

I would like to make one final point regarding consumer protection. While there may be sound national policy reasons to provide some protection to residential users from the high cost of fuel, Title II of the NGPA does not do it. Labeling Title II as a consumer protection device is misleading. Incremental pricing of natural gas was designed to protect residential consumers who utilize natural gas supplied by interstate pipelines. The consumers who heat with oil, electricity, propane, or interstate natural gas, are hurt because natural gas cost increases are passed along as part of the cost of industrial and consumer products. In effect, the majority of residential consumers subsidize the interstate natural gas consumer.

In conclusion, I wish to reiterate some of the points I raised in my statement before FERC covering incremental pricing just a few months ago. Incremental pricing under Section 202 will:

- run counter to national energy policy by encouraging industry to switch from natural gas to oil,
- make it difficult for gas utilities to plan the best ways to serve their customers or predict their revenues,
- force all consumers to pay more for the products they buy,
- present an array of technical and administrative difficulties for the Federal Energy Regulatory Commission and state public utility commissions,

- preempt historical state authority over natural gas ratemaking, and
- create uncertainty in new industrial growth and plant construction because of concern over energy prices.

We have tried to set forth the problems we foresee if Phase II is implemented. These reasons support our view that not only should any rule proposed under Section 202 be vetoed, but H.R. 5862, introduced by Congressmen Preyer and Stockman, should be enacted.

Thank you. I will be pleased to answer any questions you may have.

* * * * *

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Rule Required Under Section 202 of the Natural Gas Policy Act of 1978	))))	Docket No. RM80-10

COMMENTS OF CERTAIN ASSOCIATIONS AND INDUSTRIAL USERS OF NATURAL GAS

The undersigned associations and industrial users of natural gas hereby submit comments on the proposed implementation of Rule 2 of the incremental pricing program under Title II of the Natural Gas Policy Act (NGPA).

I.

INTRODUCTION

The undersigned respectfully call upon the Commission:

(1) to refrain from extending incremental pricing to feedstock, process, plant protection or any other non-boiler fuel use of natural gas.

(2) not simply to propose a broad application of incremental pricing under Rule 2 leaving it to Congress to veto it. Although the Congress should veto any extension of incremental pricing, the Commission should first decide not to extend incremental pricing and then be confirmed by the Congress.

(3) to recommend to the Congress that Title II of the Natural Gas Policy Act be repealed. Without rearguing the merits or demerits of incremental pricing as proposed or as finally adopted by the Congress in the light of the situation perceived at the time, suffice it to say that the situation now is vastly different. The premise of the Natural Gas Policy Act was that gas supply was short but oil supply was long. The oil crunch of today certainly belies that premise.

National energy policy has long recognized that non-boiler fuel industrial uses of natural gas are necessary to the economy and require priority treatment. The efficiency and productivity of the industrial sector is critically dependent upon these uses, including feedstock, process, plant protection, and other non-boiler uses.

In Title II of the NGPA Congress made clear its reservations against extension of incremental pricing to non-boiler fuel industrial uses. Only certain large industrial boiler fuel uses are subject to the mandatory provisions of Title II. Extension to other uses should only be made, if at all, after FERC study and analysis establish that such extension would be desirable. Congress reserves a right in either house to disapprove such an extension. Yet the Commission has proposed a blanket extension to all large non-boiler fuel industrial uses without offering sound reasons and without the study and analysis so absolutely essential to support such an extension. The Commission's failure to delineate specifically the category or categories of industrial uses that it proposes to subject to incremental pricing has led the Commission to overlook the sound public policy and economic reasons against extension to non-boiler fuel categories of industrial gas use. This failure violates the mandate of the NGPA that the Commission extend incremental pricing only to the categories of use that would further the Congressional objectives of Title II.

II.

NON-BOILER INDUSTRIAL USES OF NATURAL GAS

(a) The use of natural gas as a raw material, or feedstock, should not be subjected to incremental pricing. Feedstock use is not a fuel use; instead, the feedstock user needs the hydrogen and carbon content of the gas stream itself, creating from it man-made fibers, chemicals, and other products needed by residential, argicultural, commercial, and industrial concerns.

In addition to the above, propane, a mainstay of the rural and agricultural communities, and other essential liquids are extracted from the natural gas stream, sometimes from direct sales plants on the interstate pipeline systems.

(b) The use of natural gas in process applications should not be subjected to incremental pricing. Like feedstock use, process use has no feasible alternate fuel capability.* Process applications include direct flame applications, where it is essential that the products of combustion do not contaminate the product, as well as direct and certain indirect flame applications where precise temperature control is crucial to production of the product.

(c) The use of gas in plant protection applications should not be subjected to incremental pricing. Plant protection gas is necessary to prevent damage to the plants, to the materials in process, and, most important, to the health and safety of employees. This use does not always co-exist with other gas uses and should be separately considered. Subjecting plant protection gas to incremental pricing will do nothing to advance any of the Commission's stated objectives.

(d) Other non-boiler uses should not be subjected to incremental pricing. A myriad of industrial uses - various types of kilns, furnaces, dryers, etc. - fall into this category. These uses of gas have long been recognized as efficient and superior to boiler fuel uses. The Commission has failed to suggest any justification for including these uses within the category of uses to be covered by Rule 2.

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* Propane is not and should not be considered an alternate fuel for any process use or application.

In those industrial uses of gas, such as feedstock, process, and plant protection, there is no significant potential for conversion or additional conservation. Thus, these users cannot protect themselves with an alternate fuel and thus cannot perform the claimed "market ordering" function noticed in this rulemaking. Since some exempt uses such as large utility boilers have both conservation and conversion potential, it is arbitrary to shift costs to those users who cannot protect themselves through additional conservation or conversion.

Congress did not mandate that process and feedstock uses be subject to incremental pricing. The restriction of alternate fuel cost ceilings to any point between the costs of No. 6 and No. 2 fuel oil strongly suggests that Title II was not intended to apply to those uses for which oil is not an alternate fuel. The load loss test in Section 204(e) is not relevant with respect to process and feedstock uses. Moreover, Congress' decision to require incremental pricing only to large boiler fuel facilities and the mandating of high-priority treatment to industrial process and feedstock uses in Section 402 of the NGPA reflect additional Congressional recognition of the high-priority status of process and feedstock uses.

For those industrial uses where an alternate fuel can be used, extension of incremental pricing would encourage conversion to alternate fuels even before the alternate fuel price is reached in order to obtain supply security otherwise threatened by curtailment. In other words, if the price is comparable, these users will concentrate their efforts on supply security. As the Congress and the Commission both recognized, this would increase the unit cost of gas to residential and other exempt uses which NGPA sought to protect. Nor would extension to other non-boiler uses provide a claimed "market ordering" function. These uses do not receive a high-priority status on most curtailment schedules. As such they are exposed to curtailment just above boiler fuel uses. Interstate pipelines, in acquiring new gas supplies, make their gas buying decisions with the higher-priority users in mind since they will eventually be the recipients of these supplies.

III.

CONCLUSION

The undersigned respectfully call upon the Commission to accept the recommendations contained in these Comments.

AFG Industries, Inc.
Allegheny Ludlum Industries, Inc.
American Hoist and Derrick
American Iron and Steel Institute
American Meat Institute
Andrews Wire
Armstrong Cork Company
Arnold Print Works, Inc.
ASARCO
Associated Industries of Kentucky
Barton Enterprises, Incorporated
Bitucote Products Company
Bituminous Material, Inc.

- Borg-Warner Chemicals
- Can Manufacturers Institute
- Carolina Pipeline Company, Inc.
- Cast Metals Federation
- Celanese Chemical
- Celanese Corporation
- Certainteed Corporation
- Chamber of Commerce of the United States
- Chemplex Company
- Control Data Corporation
- Copper and Brass Fabricators Council, Inc.
- Council of Industrial Boiler Owners
  - Caterpillar Tractor Company
  - Clark Equipment Company
  - 3M Company
  - Sun Petroleum Products Company
- Cranston Print Works Company
- Dover Textiles
- Dow Chemical Company, U.S.A.
- Dyersburg Fabrics, Inc.
- Erie Mining Company
- Florida Tile
- Georgetown Ferreduction
- Georgetown Steel Corporation
- Georgetown Texas Steel Corporation
- Graniteville Company
- Greenwood Mills, Inc.
- Hanes Dye and Finishings Company
- Holland Die Casting and Plating Company, Inc.
- Industrial Gas Users Conference
  - American Steel Foundries
  - Cerro Copper Products
  - Conalco, Incorporated
  - Granite City Steel Co. (Division of National Steel Corp.)
  - Laclede Steel Company
  - NL Industries, Incorporated
  - Olin Corporation
  - Owens-Illinois, Inc.
  - Pfizer, Incorporated
  - PPG Industries, Incorporated
  - St. Joe Minerals Corporation
- Inman Mills
- Interlake, Inc.
- Jones & Laughlin Steel Corpration
- Korf Industries, Inc.
- Lukens Steel Company
- Man-Made Fiber Producers Association, Inc.

- Mayfair Mills
- Midrex Corporation
- Milwaukee Solvay Coke Company
- Mineral Insulation Manufacturers Association
- Monsanto Company
- National Association of Manufacturers
- National Clay Pipe Institute
- National Distillers and Chemical Corporation
- National Lime Association
- National Meat Canners Association
- New Jersey Chamber of Commerce
- North Star Steel
- Ohio Chamber of Commerce
- Olin Corporation
- Omaha Steel Castings Company
- Paper, Calmenson & Company
- Paxton-Mitchell Company
- Paxton & Vierling Steel Company
- Pennsylvania Chamber of Commerce
- Petrochemical Energy Group
- Phoenix Steel Corporation
- Process Gas Consumers Group
  - Aluminum Company of America
  - American Can Company
  - American Standard, Inc.
  - Armco, Inc.
  - Bethlehem Steel Corporation
  - Borg-Warner Corporation
  - Burlington Industries, Inc.
  - Chrysler Corporation
  - Cone Mills Corporation
  - Corning Glass Works
  - Dan River, Inc.
  - General Motors Corporation
  - International Harvester Company
  - Libbey-Owens-Ford Company
  - Owens-Corning Fiberglas Corporation
  - Owens-Illinois, Inc.
  - United States Steel Corporation
- Publicker Industries, Inc.
- R&G Sloane Manufacturing Company, Inc.
- Republic Steel Corporation
- Rockwool Industries, Inc.
- Rohm & Haas Company
- Rubber Manufacturers Association

Schaefer Equipment Incorporated
Superior/Ideal Incorporated
Synthetic Organic Chemical Manufacturers Association, Inc.
T.A. Schitsky & Sons
Tennessee Eastman Company (a division of Eastman Kodak Company)
The Aluminum Association, Inc.
The BFGoodrich Company
The Business Roundtable
The Carpet and Rug Institute
The Firestone Tire and Rubber Company
The Goodyear Tire and Rubber Company
The Harodite Finishing Company, Inc.
The Ohio Manufacturers' Association
The Refractories Institute
The Society of the Plastics Industry, Inc.
The Sperry and Hutchinson Company
The Susquehanna Corporation
Thomaston Mills
TRW, Incorporated
Union Carbide Corporation
Union Packing Company of Omaha
United States Gypsum Company
United Technologies
Viking Pump Division, Houdaille Industries, Inc.
Wasona Manufacturing Corporation
Wellman Industries, Incorporated
Weyerhaeuser Company
Whirlpool Corporation
Wilmington Finishing Company
Wilson Foods Corporation
Wisconsin Association of Manufacturers

Mr. DINGELL. Mr. Crittenden?

STATEMENT OF E. D. CRITTENDEN

Mr. CRITTENDEN. Thank you, Mr. Chairman. I am E. D. Crittenden, vice president of Hercules, Inc. Today I am appearing on behalf of the Petrochemical Energy Group—PEG—an ad hoc group of independent U.S. chemical companies who use hydrocarbons including natural gas for essential raw materials or feedstocks, process and other nonboiler and boiler uses.

With me is Gordon Gooch who is PEG's general counsel and who will be happy to respond to your questions, as will I. PEG has previously testified before FERC on phase II and has subscribed to the "Comments of Certain Associations and Industrial Users of Natural Gas" filed in FERC docket No. RM80-10.

We appreciate very much the opportunity to be heard on the issue of whether the FERC's proposal to expand incremental pricing to all industrial uses of natural gas should be approved or disapproved by the Congress. The Congress specifically reserved to itself the ultimate decision on whether incremental pricing would be extended to feedstock, process, plant protection and other nonboiler fuel uses of natural gas.

Indeed, the FERC has conceived its role in this issue as merely to provide a clear choice to the Congress, and this it has done. We urge disapproval because artificially raising the price of gas to high-priority uses, such as feedstock, process, and plant protection, has no significant conservation potential.

A cut in gas use for these purposes means a cut in production. An increase in gas surcharges for these uses means a decrease in cost for some boiler fuel uses. Phase II will not operate as a market-ordering device since the feedstock and process user does not have leverage with the pipeline, being dependent upon natural gas.

Phase II, as estimated by the FERC staff, would reduce residential—and all other exempt boiler and nonboiler fuel users' gas costs—by about 13 cents per Mcf, yet add an additional 60 cents per Mcf to the high-priority industrial's cost of gas.

The FERC's perception of incremental pricing, as stated by Chairman Curtis, is to meet "the dual objectives of preparing the natural gas market for deregulation and providing a measure of price sheltering to high-priority consumers."

The phase II rule will not effectively accomplish the stated purposes. The extension of incremental pricing beyond boilers to all industrial nonboiler uses will not serve to accomplish the goal of "market ordering." The underlying theory is that incrementally priced industrial boiler fuel users would pressure gas pipelines to hold down the prices bid for deregulated gas purchased from producers.

This pressure would be applied by threat of industrial load loss as boilers flee to alternate fuels, either coal or oil. But the question is, does the theory, if valid, have any applicability when applied to uses which cannot use alternate fuels?

FERC itself has now recognized that phase II would not contribute to the market ordering objective in its recent "Summary of Commission Discussion on Phase II Congressional Submittal," March 25 summary. FERC reached this conclusion based on the fact that industrial-end users covered in phase II, such as feedstock and process users, have little or no capability to switch to alternative fuels and, therefore, are in a "relatively weak position to affect prices that pipelines will pay for natural gas." PEG concurs in this judgment.

The second objective is said to be "price sheltering" for residential and other high-priority consumers. Those in the protected class are larger than residential users, including nonindustrial boiler fuel users. Thus, focusing only on the impact on residentials is somewhat misleading.

Yet, if the primary concern of the Congress relates to the impact on the residential consumer, there is a basic flaw in the Commission staff's "Comparison of Industrial versus Residential Gas Costs." That comparison, attached to the March 25 summary, concludes that "significantly, the price of gas to incrementally priced industrial users will still be less than the price of gas to interstate residential users in virtually every instance"—if No. 6 oil is used as the cap.

Perhaps the staff will consider in its final report that a large part of the $3.59 per MMBtu attributed to the residential user is, in fact, the cost of a large, low volume, door-to-door, street-by-street distribution system necessary to serve individual and collective residences, not industrials.

This distribution system must be large enough to meet peak demands, yet remain only partially used at other times of the year.

If the $3.59 assumption for residential users is correct, about $1.40 per Mcf is attibutable to the cost of distribution at the retail level.

Significantly, while the resale that is wholesale rate was $2.19, the average gas sale price to the direct industrial firm noninterruptible user was $2.31 while the average gas sale price to the direct industrial interruptible user was $2.05.

We respectfully suggest that a more accurate assessment of the impact of incremental pricing on the firm nonboiler fuel user of natural gas, such as the feedstock and process user who needs a firm supply of gas year round, should be made recognizing that the firm industrial user already pays as much or more than the residential user of natural gas when the costs of distribution are considered.

FERC announced in its March 25 summary that the average household that heats and cooks with gas would receive a benefit of slightly more than $23 per year if incremental pricing were extended in the manner contemplated by FERC. The Commission properly points out that the significance of this estimated savings is lessened because "incremental pricing provides shelter to all high-priority users, regardless of their economic need for this or any other subsidy."

For this reason, FERC concluded: "Other mechanisms might more successfully transfer assistance to those low-income families in need of relief from rising gas costs. However, such mechanisms are not contained in title II."

There are other factors which further reduce the protection or benefit that might accrue to residential consumers. Many residences use fuel oil, propane, electricity, or other fuel instead of gas and will receive none of the benefit.

Yet under phase II, these residentials would also have to bear the higher cost for industrial goods that will result from industry paying incremental surcharges. Thus, under the contemplated phase II rule, all consumers must pay higher prices for goods in order that some residential interstate gas consumers can get what is at most a modest reduction in their gas bills.

In considering whether this is an appropriate result, the Congress should recognize that those using gas for residential heating are already benefiting from rates substantially lower than those of their neighbors using oil and electricity. Even without the additional incremental pricing benefit of phase II, these gas users will continue to benefit from Federal price controls on natural gas, fully in place through 1984 and partially in place permanently under current law.

This disparity in treatment works most unfairly in those States in which residential consumers rely more heavily on distillate fuel, LPG, or other fuel, than on natural gas. As illustrated in the attached appendix [See p. 34.], residentials in many States including all of the New England States, New York, New Jersey, Florida, Delaware, North Carolina, and Oregon rely more heavily on the more expensive distillate fuel than gas.

In States such as Florida, residentials also rely far more heavily on other fuels such as LPG and electricity. In still other States, residentials do not have access to interstate gas supplies. The average consumer in all of these States may suffer a significant net economic detriment under incremental pricing, because he must bear the higher costs for goods that will result from incremental pricing, but will receive no benefit.

Conservation is the test for phase II. We would respectfully suggest that the test to be applied by the Congress in deciding whether to approve or to disapprove extension of incremental pricing to nonboiler fuel uses is a conservation standard. Would extension of incremental pricing to the nonboiler fuel user increase or decrease the effective use of this resource?

First, please consider that an extension of incremental pricing operates to encourage boiler fuel use both by reducing gas prices to exempt boilers and by spreading the surcharge account for nonexempt boilers to nonboiler fuel uses.

Second, please consider that the FPC, the FERC, and the Congress [in adopting section 402 of the Natural Gas Policy Act] have recognized the essential nature of feedstock, process, plant protection as compared to boiler fuel use.

Because feedstock and process users have no practicable conservation or conversion potential, extension of incremental pricing to these users would be arbitrary and unfair. These users cannot protect themselves against the burden of incremental pricing by installing alternate fuel capability or adopting conservation measures as some boiler fuel users can.

The Commission's contemplated phase II rule calls upon the captive feedstock and process user to pay costs of gas associated with new supplies needed for users who have the potential for conversion and conservation, but who are permitted to continue to demand natural gas at less than "rolled-in" prices.

Therefore, PEG respectfully urges the Congress to disapprove FERC's anticipated phase II rule.

Thank you.

[Testimony resumes on p. 43.]

[Mr. Crittenden's prepared statement and attachment follow:]

STATEMENT OF THE PETROCHEMICAL ENERGY GROUP

(Presented by E. D. Crittenden, Hercules, Inc.)

I am E. D. Crittenden, Vice President of Hercules, Incorporated. Today I am appearing on behalf of the Petrochemical Energy Group (PEG), an ad hoc group of independent U.S. chemical companies who use hydrocarbons including natural gas for essential raw materials or feedstocks, process and other non-boiler and boiler uses. With me is Gordon Gooch who is PEG's General Counsel and who will be happy to respond to your questions as will I. PEG has previously testified before FERC on Phase II and has subscribed to the "Comments of Certain Associations and Industrial Users of Natural Gas" filed in FERC Docket No. RM80-10.

We appreciate very much the opportunity to be heard on the issue of whether the FERC's proposal to expand incremental pricing to all industrial uses of natural gas should be approved or disapproved by the Congress. The Congress specifically reserved to itself the ultimate decision on whether incremental pricing would be extended to feedstock, process, plant protection and other non-boiler fuel uses of natural gas. Indeed, the FERC has conceived its role in this issue as merely to provide a clear choice to the Congress, and this it has done. We urge disapproval.

The FERC's perception of incremental pricing, as stated by Chairman Curtis, is to meet "the dual objectives of preparing the natural gas market for deregulation and providing a measure of price sheltering to high-priority consumers."

I.

The Phase II Rule Will Not Effectively Accomplish the Stated Purposes.

1. Extension of incremental pricing beyond boilers to all industrial non-boiler uses will not serve to accomplish the goal of "market ordering."

The underlying theory is that incrementally priced industrial boiler fuel users would pressure gas pipelines to hold down the prices bid for deregulated gas purchased from producers. This pressure would be applied by threat of industrial load loss as boilers flee to alternate fuels, either coal or oil. But the question is, does the theory, if valid, have any applicability when applied to users which cannot use alternate fuels?

FERC itself has now recognized that Phase II would not contribute to the market ordering objective in its recent "Summary of Commission Discussion On Phase II Congressional Submittal." (March 25 Summary). There the Commission concluded: "Although market instability in 1985 is a significant and real concern, the record demonstrates that the market ordering purpose of Title II is unlikely to be achieved by expanding incremental pricing beyond industrial boiler fuel users." FERC reached this conclusion based on the fact that industrial-end users covered in Phase II, such as feedstock and process users, have little or no capability to switch to alternative fuels and therefore are in a "relatively weak position to affect prices that pipelines will pay for natural gas." PEG concurs in this judgment. Unless these users cut back production or go out of business, they must pay whatever price the pipelines charge.

DOE reached the same conclusion in its comments to FERC filed on February 8, 1980 in the Phase II rulemaking proceeding.

2. The second objective is said to be "price sheltering" for residential and other high-priority consumers.

Those in the protected class are larger than residential users, including nonindustrial boiler fuel uses. Thus, focusing only on the impact on residentials is somewhat misleading.

Yet, if the primary concern of the Congress relates to the impact on the residential consumer, there is a basic flaw in the Commission Staff's "Comparison of Industrial versus Residential Gas Costs." That comparison, attached to the March 25 Summary, concludes that "significantly, the price of gas to incrementally priced industrial users will still be less than the price of gas to interstate residential users in virtually every instance" [if No. 6 oil is used as the cap].

Perhaps the staff will consider in its final report that a large part of the $3.59 per MMBtu attributed to the residential user is, in fact, the cost of a large, low volume, door-to-door, street-by-street distribution system necessary to serve individual and collective residences, not industrials. This distribution system must be large enough to meet peak demands yet remain only partially used at other times of the year. An order of magnitude of the cost of this distribution system can be found by examining EIA Order No. 725 Statistics on Interstate Natural Gas Pipeline Companies. For example, in November 1979, the price charged by interstate pipelines for sales for resale to intrastate gas companies under FERC rate schedules was $2.19. Thus, if the $3.59 assumption for residential uses is correct, about $1.40 per Mcf is attributable to the cost of distribution at the retail level.

Significantly, while the resale (i.e., wholesale) rate was $2.19, the average gas sale price to the direct industrial *firm* (non-interruptible) user was $2.31 while the average gas sale price to the direct industrial *interruptible* user was $2.05.

We respectfully suggest that a more accurate assessment of the impact of incremental pricing on the firm non-boiler fuel user of natural gas, such as the feedstock and process gas user who needs a firm supply of gas year round, should be made recognizing that the firm industrial user already pays as much or more than the residential user of natural gas when the costs of distribution are considered.

FERC announced in its March 25 Summary that the average household that heats and cooks with gas would receive a benefit of slightly more than $23 per year if incremental pricing were extended in the manner contemplated by FERC. The Commission properly points out that the significance of this estimated savings is lessened because "incremental pricing provides shelter to all high-priority users, regardless of their economic need for this or any other subsidy." For this reason FERC concluded: "Other mechanisms might more successfully transfer assistance to those low income families in need of relief from rising gas costs. However, such mechanisms are not contained in Title II."

There are other factors which further reduce the protection or benefit that might accrue to residential consumers. Many residences use fuel oil, propane, electricity or other fuel instead of gas and will receive none of the benefit. Yet under Phase II, these residentials would also have to bear the higher cost for industrial goods that will result from industry paying incremental surcharges. Thus, under the contemplated Phase II rule, all consumers must pay higher prices for goods in order that some residential interstate gas consumers can get what is at most a modest reduction in their gas bills.

While providing this benefit to some residential gas users, the contemplated Phase II rule would also be disruptive to industrial users. By treating all industrial end uses of gas alike, the Phase II rule penalizes superior end uses regardless of efficiency and necessity, and compels these superior uses to assume costs attributable to boiler fuel use.

Since gas used in some boilers will be exempt, the costs associated with gas used under these boilers will be shifted in Phase II to feedstock, process, plant protection, and other non-boiler uses. Thus, the high priority user is forced to subsidize the boiler fuel user--even though feedstock, process and plant protection users have no alternate fuel, and cannot "conserve" or "convert" to mitigate the consequences.

The brunt of Phase II incremental pricing also falls on feedstock and process gas users who are unable to substitute coal for either gas or oil, and therefore are least likely to be able to influence a pipeline's purchasing decisions. In general, the same is true for other non-boiler fuel uses which are also superior end uses, even when there is an alternate fuel capability. PEG respectfully submits that it is unwise policy to include these superior end uses in the incremental pricing scheme simply to shield either boiler fuel users or other users from the costs of natural gas which they themselves consume.

In considering whether this is an appropriate result, the Congress should recognize that those using gas for residential heating are already benefiting from rates substantially lower than those of their neighbors using oil and electricity. Even without the additional incremental pricing benefit of Phase II, these gas users will continue to benefit from federal price controls on natural gas, fully in place through 1984 and partially in place permanently under current law.

This disparity in treatment works most unfairly in those States in which residential consumers rely more heavily on distillate fuel, LPG or other fuel than on natural gas. As illustrated in the attached Appendix, residentials in many states including all of the New England states, New York, New Jersey, Florida, Delaware, North Carolina, and Oregon rely more heavily on the more expensive distillate fuel than gas. In states such as Florida, residentials also rely far more heavily on other fuels such as LPG and electricity. In still other states, residentials do not have access to interstate gas supplies. The average consumer in all of these states may suffer a significant net economic detriment under incremental pricing, because he must bear the higher costs for goods that will result from incremental pricing but will receive no benefit.

II.

Incremental Pricing Has Caused States To Impose Disruptive State Plans.

A number of states have begun imposing their own incremental pricing plans. Under these plans, industrials are priced up to the ceiling cap, thereby eliminating all surcharge absorption capability in the state. Thus, customers in states without such plans will absorb more than a pro rata share of incremental pricing surcharges, absorbing surcharges that would be otherwise borne by industrials in states having adopted plans. In some cases, where a pipeline system serves a number of states with their own incremental pricing plans, higher proportions of the surcharge account will have to be absorbed by all of the pipeline's customers because the ceiling cap will be reached by industrials in the remaining states, causing the unabsorbed surcharges to spillover to all customers under the PGA. The result will be an arbitrary and inequitable application of federal incremental pricing.

III.

Conservation is the Test for Phase II

We would respectfully suggest that the test to be applied by the Congress in deciding whether to approve or to disapprove extension of incremental pricing to non-boiler fuel uses is a conservation standard. Would extension of incremental pricing to the non-boiler fuel user increase or decrease the effective use of this resource?

First, please consider that an extension of incremental pricing operates to encourage boiler fuel use both by reducing gas prices to exempt boilers and by spreading the surcharge account for non-exempt boilers to non-boiler fuel uses.

Second, please consider that the FPC, the FERC, and the Congress (in adopting § 402 of the Natural Gas Policy Act) have recognized the essential nature of feedstock, process, plant protection as compared to boiler fuel use.

Because feedstock and process users have no practicable conservation or conversion potential, extension of incremental pricing to these users would be arbitrary and unfair. These users cannot protect themselves against the burden of incremental pricing by installing alternate fuel capability or adopting conservation measures as some boiler fuel users can. The Commission's contemplated Phase II rule calls upon the captive feedstock and process user to pay costs of gas associated with new supplies needed for users who have the potential for conversion and conservation but who are permitted to continue to demand natural gas at less than "rolled-in" prices.

The use of natural gas to protect plant equipment and materials and to ensure the safety and health of plant employees has been given the highest priority for curtailment purposes by the Department of Energy along with residential, hospital and small commercial uses. This use of natural gas is sometimes made by concerns not using gas for any other industrial use, and there is no sound energy policy reason to subject this critical gas use to incremental pricing.

IV.

Conclusion

Artificially raising the price of gas to high-priority users, such as feedstock, process, and plant protection, has no significant conservation potential.

- a cut in gas use for these purposes means a cut in production
- an increase in gas surcharges for these uses means a decrease in cost for some boiler fuel uses

Phase II will not operate as a market-ordering device since the feedstock and process user does not have leverage with the pipeline, being dependent upon natural gas.

Phase II, as estimated by the FERC staff, would reduce residential--and all other exempt boiler and non-boiler fuel users' gas costs by about 13 cents per Mcf yet add an additional 60 cents per Mcf to the high-priority industrial's cost of gas. Measured at the wholesale level, before distribution costs, this approximates a cost of $2.80 to $2.90 for affected Phase II firm industrials and $2.07 for residentials and exempt users, using November 1979 data as a guide.

But this appears to exceed the No. 6 oil price when distribution costs are considered, if the FERC staff estimate is correct. And this ignores the impact of state plans which pre-empt the operation of the federal plan.

Therefore, PEG respectfully urges the Congress to disapprove FERC's anticipated Phase II rule.

Trillion BTUs of Relative Fuels by Residential Consumers 1977

State	Distillate	LPG	Natural Gas	Electricity	Total*
Connecticut	97.6	3.4	32.1	27.3	163.4
Maine	46.0	3.4	.77	9.8	66.1
Vermont	12.6	2.5	1.2	5.3	23.6
New Hampshire	28.0	3.2	4.0	8.1	45.7
Massachusetts	173.6	5.0	96.2	39.5	320.5
Rhode Island	28.5	.71	14.0	6.1	50.0
TOTAL	386.3	18.2	148.3	96.1	669.3

Source: Federal Energy Data System Statistical Summary Update, July 1979
(DOE/EIA-0192 Order No. 303)

*includes all fuels

Trillion BTUs of Relative Fuels by Residential Consumers 1977

State	Distillate	LPG	Natural Gas	Electricity	Total*
New Jersey	140.0	5.0	138.4	52.8	351.5
New York	438.4	14.1	356.7	101.6	947.5
Pennsylvania	169.4	9.8	286.2	103.5	609.3
TOTAL	747.8	28.9	781.3	257.9	1908.3

*includes all fuels

EAST NORTH CENTRAL

Trillion BTUs of Relative Fuels by Residential Consumers 1977

State	Distillate	LPG	Natural Gas	Electricity	Total*
Illinois	91.6	39.6	536.6	96.5	778.3
Indiana	79.2	29.1	156.5	61.7	336.1
Michigan	98.0	23.2	308.8	74.3	515.1
Ohio	77.7	20.1	425.1	105.9	669.1
Wisconsin	93.7	22.9	123.1	43.9	290.6
TOTAL	440.2	134.9	1550.1	382.3	2589.2

*includes all fuels

WEST NORTH CENTRAL

Trillion BTUs of Relative Fuels by Residential Consumers 1977

State	Distillate	LPG	Natural Gas	Electricity	Total*
Iowa	21.1	28.3	89.7	30.7	171.5
Kansas	4.4	19.7	97.6	24.3	148.0
Minnesota	72.3	24.1	103.7	37.5	243.3
Missouri	20.0	39.5	159.0	50.1	272.3
Nebraska	8.5	11.9	54.6	17.4	95.5
North Dakota	5.2	5.0	10.5	7.4	29.5
South Dakota	4.6	8.6	14.6	7.9	36.7
TOTAL	136.1	137.1	529.7	175.3	996.8

*includes all fuels

SOUTH ATLANTIC

Trillion BTUs of Relative Fuels by Residential Consumers 1977

State	Distillate	LPG	Natural Gas	Electricity	Total*
Delaware	8.0	1.6	7.4	5.5	23.7
Florida	23.1	25.5	18.8	132.0	206.6
Georgia	8.8	18.8	80.8	65.1	176.2
Maryland	45.1	5.6	67.3	36.7	160.7
D.C.	6.7	---	12.8	3.5	24.6
North Carolina	39.1	10.0	33.3	76.0	197.5
South Carolina	18.5	8.3	32.9	39.0	107.4
Virginia	45.5	7.1	47.4	61.0	177.1
West Virginia	9.1	1.5	53.3	19.3	86.7
TOTAL	203.9	78.4	354.0	437.8	1160.5

*includes all fuels

Trillion BTUs of Relative Fuels by Residential Consumers 1977

State	Distillate	LPG	Natural Gas	Electricity	Total*
Alabama	1.5	20.2	58.3	54.4	139.4
Kentucky	9.8	16.6	97.7	41.5	177.2
Mississippi	.6	19.5	26.8	30.5	87.5
Tennessee	4.3	10.6	44.9	88.6	165.1
TOTAL	16.2	66.9	227.7	215.0	569.2

*includes all fuels

WEST SOUTH CENTRAL

Trillion BTUs of Relative Fuels by Residential Consumers 1977

State	Distillate	LPG	Natural Gas	Electricity	Total*
Arkansas	1.0	1.9	39.5	26.8	72.4
Louisiana	.6	9.1	97.4	51.2	175.3
Oklahoma	.3	24.0	89.6	35.8	151.1
Texas	1.3	45.8	278.6	159.8	524.4
TOTAL	3.2	80.8	505.1	273.6	923.2

*includes all fuels

MOUNTAIN

Trillion BTUs of Relative Fuels by Residential Consumers 1977

State	Distillate	LPG	Natural Gas	Electricity	Total*
Arizona	1.0	1.9	39.5	26.8	72.4
Colorado	1.4	12.1	103.1	19.6	138.3
Idaho	12.1	3.0	12.4	15.0	44.6
Montana	6.9	4.2	22.3	8.3	42.3
Nevada	2.4	1.3	11.5	10.0	25.9
New Mexico	.4	5.8	26.3	7.5	44.8
Utah	2.7	2.0	36.7	9.9	54.4
Wyoming	.5	4.1	11.5	3.7	21.1
TOTAL	27.4	34.4	263.3	100.8	443.8

*includes all fuels

PACIFIC

Trillion BTUs of Relative Fuels by Residential Consumers 1977

State	Distillate	LPG	Natural Gas	Electricity	Total*
Alaska	6.1	.3	11.6	3.8	22.4
California	5.2	9.8	559.1	158.0	748.0
Oregon	15.9	1.6	10.4	43.0	73.2
Washington	22.8	2.0	31.5	77.8	138.3
TOTAL	50.0	13.7	612.6	282.6	981.7

*includes all fuels

Mr. DINGELL. Thank you very much.

Our next witness will be Mr. Andrew S. Merrels. Mr. Merrels, we will be pleased to receive your statement.

STATEMENT OF ANDREW S. MERRELS

Mr. MERRELS. Mr. Chairman and members of the subcommittee, my name is Andrew S. Merrels, and I am director of energy purchases and hydrocarbon ventures for Owens-Corning Fiberglas Corp. I am appearing here today on behalf of the Process Gas Consumers Group, the American Iron and Steel Institute, and the Georgia Industrial Gas Group. With me are Henry E. Miller, who is assistant vice president, corporate operating affairs, Armco, Inc., and Edward J. Grenier, Jr., of the law firm of Sutherland, Asbill & Brennan, counsel to the groups.

We have submitted to the subcommittee a detailed written statement of our position on the Commission's proposed phase II program for the record [See p. 46.] and will take only a few minutes now to summarize our points.

Before turning to the Commission's outline of its phase II proposal, we feel compelled to state our belief that title II constitutes economically unsound, unwise, and harmful legislation. The so-called incremental pricing mandated by title II represents unduly discriminatory ratemaking, and its deficiencies and adverse consequences far outweigh any of its intended benefits.

This statute will have severe consequences for the Nation's economy and, ironically, will hurt the very segment of consumers it was intended to help, as well as the greater majority of consumers which it was not intended to help. For this reason, we actively support the passage of the Preyer-Stockman bill, H.R. 5862, and the Lugar-Stevenson bill, S. 2392, to repeal title II in its entirety.

With respect to the phase II outline announced March 20 in the Commission's news release, it is the group's recommendation that Congress should adopt a resolution of disapproval if a section 202 rule following that outline is ultimately submitted for congressional review.

While there are portions of the proposal which the groups favor, the proposal to expand incremental pricing to cover all industrial uses not specifically exempted by statute—that it dictates our recommendation for veto of the proposed rule. The specific elements of the proposal to which we object are described in greater detail in our written statement.

Preparation of the natural gas market for deregulation cannot be achieved through incremental pricing under title II, and most certainly cannot be achieved or even furthered through the broad phase II expansion contemplated by the Commission. Instead, the market distortions caused by price regulation in the first place will be perpetuated, and new and even greater distortions will be introduced into the economy.

The market ordering potential of incremental pricing generally and the Commission's original phase II proposal specifically have been thoroughly and soundly rejected by the Department of Energy, by the Commission itself, and by Jensen Associates, a consultant on energy economics, whose critique on incremental pricing has been submitted to the subcommittee with our written statement.

Title II and its proposed expansion under phase II are also incapable of achieving the other stated goal of incremental pricing—to shield through subsidy certain consumers from the higher gas rates resulting from phased decontrol of wellhead prices. Apart from the question of whether such subsidies represent sound energy policy in the current energy climate, it has become clear that incremental pricing will not, in fact, advance the aim of "price shielding."

According to both the Commission and the Department of Energy, the rate benefits of phases I and II combined will be approximately $2 per month for the typical household that heats and cooks with gas. While we believe that even these numbers are inflated—due to the agencies' failure to take a number of key factors into account—it is compellingly clear, even on the basis of these projections, that the potential savings to exempt consumers from incremental pricing are simply not worth that scheme's inflationary impact on the prices of consumer goods, its effect on oil imports, its adverse impact on utility revenue stability, and its substantial implementation cost.

Even these imperceptible benefits, however, will be available only to those homeowners served by the interstate gas system. Millions of American families who receive their gas from the intrastate system or, more significantly, who heat with something other than gas, will receive no subsidy whatsoever for their fuel bills.

Nonetheless, these consumers will have to bear the higher costs of manufactured goods as a result of incremental pricing. Moreover, even the statute's intended beneficiaries will enjoy only a short-term benefit; as gas utilities lose industrial load to the oil sellers who are actively undercutting the posted gas ceiling prices, exempt consumers will find their gas bills increasing as they bear a larger percentage of the utilities' high gas costs and fixed charges.

The concentration of new, high gas costs on industrial users cannot help but have adverse consequences for the economy generally. On the one hand, many industrial companies will be forced to pass through the higher costs to all consumers in the form of higher product prices for consumer goods.

On the other hand, not all companies—especially those threatened by foreign competition—will be able to recover these higher costs by raising their prices. For some, this will mean lower profits, lower productivity, employment cutbacks, and increased difficulties for capital formation.

For others, it will mean being pushed over the edge—to the point of not being able to compete with companies served by the intrastate market and with companies located in Canada and Mexico, none of which are subject to the burdens of incremental pricing.

More than half of the States have taken steps to thwart title II and to shift the statute's burdens to other States. These actions are distorting State ratemaking practices and compounding the inequities of the incremental pricing program.

In the absence of a Commission prohibition on adoption of these so-called zero MSAC plans, only repeal of title II can remedy these distortions and restore the fact of ratemaking authority—rather than its mere appearance—to the States, where it was before title II was enacted and where it properly belongs.

It is appropriate for Congress to reassess the economic and social judgments which it made a year and a half ago. The Commission's proposed section 202 rule ignores the overwhelming evidence—from its regional hearings and from hundreds of filed comments—of the disastrous consequences of an expanded incremental pricing program.

The Commission apparently believes, in our view, erroneously, that Congress simply expected it to submit a very broad rule, and that is what it has done. It has declined to evaluate the current vitality of the purposes originally sought to be achieved by that rule, and it has declined to state whether the rule should be vetoed or approved.

The Commission has stated, in effect, that the incremental pricing ball is now in Congress court. It is, therefore, up to Congress to state its own recognition that circumstances have indeed changed dramatically since 1978, that incremental pricing cannot in any event achieve "market ordering," that the benefits of incremental pricing to its intended beneficiaries are, even under the best circumstances, negligible, if not invisible, that the program abounds with distortions and inequities, and that the potential for serious economic dislocation and severe harm to the Nation's economy is far greater than was realized at the time the NGPA was enacted.

Accordingly, PGC, AISI, and GIG respectfully urge the House to adopt a resolution of disapproval of the Commission's proposed section 202 rule. In addition, Congress should, as expeditiously as possible, proceed to pass H.R. 5862 and S. 2392 to repeal title II in its entirety.

Thank you for the opportunity of appearing before you today. Mr. Miller, Mr. Grenier, and I will be pleased to answer whatever questions you may have.

Thank you.

[Testimony resumes on p. 73.]

[Mr. Merrel's prepared statement follows:]

UNITED STATES OF AMERICA
BEFORE THE
HOUSE OF REPRESENTATIVES
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
SUBCOMMITTEE ON ENERGY AND POWER

STATEMENT OF THE PROCESS GAS CONSUMERS GROUP, THE AMERICAN IRON AND STEEL INSTITUTE, AND THE GEORGIA INDUSTRIAL GAS GROUP

Mr. Chairman and Members of the Subcommittee:

My name is Andrew S. Merrels. I am Director of Energy Purchases & Hydrocarbon Ventures for Owens-Corning Fiberglas Corporation and I am appearing today on behalf of the Process Gas Consumers Group ("PGC"), the American Iron and Steel Institute ("AISI"), and the Georgia Industrial Gas Group ("GIG"). With me are Henry E. Miller, Assistant Vice President, Corporate Operating Affairs, Armco, Inc., and Edward J. Grenier, Jr., of the law firm of Sutherland, Asbill & Brennan, counsel to the three Groups.

Introduction

PGC is an association organized to promote the development and adoption of coordinated, rational, and consistent federal and state policies which will assure an adequate and reliable supply of natural and manufactured gas at just and reasonable cost-based rates for industrial gas uses which cannot technically or economically be converted to alternative fuels. Members of PGC participating in this hearing, all of whom consume natural gas in high-priority process gas uses, in boiler fuel uses, and in other uses, are: Aluminum Company of America, American Can Company, American Standard Inc., Armco, Inc., Bethlehem Steel Corporation, Borg-Warner Corporation, Burlington Industries, Inc., Chrysler Corporation, Cone Mills Corporation, Corning Glass Works, Dan River, Inc., General Motors Corporation, Libbey-Owens-Ford Company, Owens-Corning Fiberglas Corporation, Sikes Corporation, 3M Company, and United States Steel Corporation. PGC members own and operate over 1,000 plants in virtually every state in the nation.

AISI is the trade association for the steel industry; its sixty-three domestic member companies account for 93 percent of the raw steel production capability in the United States. (Armco, Bethlehem Steel, and United States Steel, members of PGC, are also members of AISI.)

The following members of the Georgia Industrial Gas Group are also participating: American Industrial Clay Company of Sandersville, Anglo-American Clays Corporation, Burgess Pigment Company, Chemical Products Corporation, Engelhard Minerals & Chemicals Corporation, Freeport Kaolin Company, Georgia Kaolin Company, Griffin Pipe Products Company, and Thiele Kaolin Company. (General Motors, a member of PGC, is also a member of GIG.) These companies all operate industrial facilities which consume natural gas in the State of Georgia.

Mr. Chairman, the Groups -- PGC, AISI, and GIG -- have participated actively in each and every one of the various incremental pricing proceedings before the Federal Energy Regulatory Commission (FERC) during the past 15 months. The Groups have responded to FERC's invitation to submit constructive input on its proposals to implement Title II of the Natural Gas Policy Act of 1978 (NGPA), and they have urged FERC to exercise its discretion toward mitigating the serious economic and social dislocations resulting from that statute.

However, while participating actively at the administrative level in an effort to assist FERC in carrying out its statutory mandate most responsibly, the Groups have consistently believed that Title II constitutes economically unsound, unwise, and harmful legislation. The so-called "incremental pricing" mandated by Title II represents unduly discriminatory ratemaking, and its deficiencies and adverse consequences far outweigh any of its intended benefits. In view of current economic conditions, Title II will likely have economic consequences far more severe than were anticipated by Congress. And this scheme will hurt the very segment of consumers it was intended to help, as well as the greater majority of consumers which it apparently had no intention of helping.

Consequently, the Groups believe that Congress should repeal Title II in its entirety. For this reason, we actively support the passage of the Preyer-Stockman bill -- H.R. 5862 -- in the House and the Lugar-Stevenson bill -- S. 2392 -- in the Senate. Whatever Congress may have perceived the merits of "incremental pricing" to be when it enacted the NGPA in 1978, it is indisputable that relevant conditions have changed dramatically since that time. As a result, the impact of Title II on all sectors of the economy will likely be much greater -- and, in some cases, much different -- than was originally anticipated. The time has come for Congress to re-examine the social and economic judgments it made when it enacted Title II and to recognize (1) that those judgments are not appropriate today and (2) that, even if Congress still adheres to those judgments and goals, "incremental pricing" under Title II is inherently incapable of implementing or achieving them.

Whatever may have been perceived in 1978, it is painfully clear -- and, with respect to the nation's economy, I emphasize the word "painfully" -- that "incremental pricing" under Title II today represents neither sound, wise, nor responsible energy policy.

FERC's Proposed Section 202 Rule -- Recommendations

On March 20, 1980, FERC issued a News Release (FE-810) announcing "a possible approach to implementation of the second phase of the incremental pricing program mandated by Title II . . . ." On March 25, 1980, FERC issued a "Summary of Commission Discussion on Phase II Congressional Submittal." It is our understanding that today's hearing has been convened to examine the impact and effects of the Commission's proposed Section 202 rule, as it has been described in those two documents.

Assuming, then, that the described proposal is in fact submitted by May 9, 1980, for Congressional review as the required Section 202 rule, the Groups state their position thereon as follows:

(1) The Groups oppose the intended expansion of incremental pricing to cover all industrial uses not specifically exempted by statute. Instead, they believe that the Section 202 rule should limit the applicability of Title II to only industrial boiler fuel facilities (as defined under the Phase I rules), *i.e.*, define no additional category of industrial facility (under Section 202(b)(2)) as subject to the incremental pricing requirements.

(2) The Groups favor the proposed establishment of a uniform price ceiling for non-exempt users at the price of No. 6 high-sulfur residual fuel oil. However, this "fuel cap" should be applicable to all non-exempt uses -- both boiler and non-boiler -- and the Groups oppose any proposal to implement the three-tier approach (described in Order No. 50, FERC Docket No. RM79-21) with respect to any non-exempt use, either now or in the future.

(3) The Groups support the proposed adoption of a "deductible"-style exemption for small facilities but oppose the Commission's intention to apply this exemption with respect to non-boiler uses only. Regardless of the ultimate scope of non-exempt gas consumption, the first 300 Mcf of all

such consumption should be exempt from incremental pricing surcharges. */

(4) The Groups seriously question the wisdom of the proposal to give the states the discretion to limit the first year impact of Phase II to $.75 per Mcf to any industrial user. While this proposal has not yet been sufficiently described to permit meaningful comment, the Groups believe that such a provision could result in a morass of administrative proceedings as the states attempt to adjudicate individual claims for relief. Such a provision could well pit non-exempt users against one another -- vying to transfer rather than receive surcharges -- with relief going to those with the most clout and additional burdens imposed on those without alternate fuel capability. While the Groups appreciate the Commission's sensitivity to the severe cost impacts of Phase II, they believe that the "$.75 limit" proposal, as described thus far, is not an appropriate solution to the problem.

(5) The record developed in the Commission's Phase II proceedings is devoid of any evidence to support a broad Section 202 rule; in fact, the record overwhelmingly supports a narrow rule which would mitigate the harmful consequences of Title II to the greatest practicable extent. Thus, the Groups respectfully disagree with FERC's intention to sub-

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*/ This proposal and the justification for it are explained in the Groups' Comments, filed April 4, 1980, in FERC Docket Nos. RM79-48 and RM80-24.

mit its Section 202 rule proposal to Congress without a recommendation reflecting that record. The Commission's final submission to Congress should reflect the informed judgment that Title II is inconsistent not only with Congress' own 1978 legislative purposes but also with the broad public interest as it has actually developed since that time. Accordingly, the Commission should recommend to Congress that the scope of incremental pricing should not be expanded during Phase II and, beyond that, that Title II should be repealed in its entirety. If FERC somehow believes (erroneously) that it is legally required to submit a broad Section 202 rule, it should at least accompany it with a recommendation that a Congressional veto of such a rule would be in the public interest.

While today's hearing is apparently intended to focus on the broad outline of the proposed Phase II announced in the Commission's March 20 News Release, the implementation of any Phase II necessarily involves many more issues and administrative problems than were addressed in the News Release. For that reason, the Groups are submitting to the Subcommittee a copy of their detailed written Comments, filed on February 8, 1980, in FERC Docket No. RM80-10, with respect to all aspects of the Phase II program proposed by the Commission on November 15, 1979. Submitted to the Commission as a part of those Comments was a report prepared by Jensen Associates, Inc. That report, entitled "A Critique of Incremental Pricing Under the

Natural Gas Policy Act of 1978," is also being submitted to the Subcommittee today and is commended to the attention of its members.

Section 507(c)(3) of the NGPA contemplates that the Section 202 rule submitted to Congress by the Commission shall simply be voted either up or down. There appears to be no provision for approving one or more portions of a submitted rule while disapproving others. Such being the case, it is the Groups' recommendation, in light of the positions stated above, that Congress should adopt a resolution of disapproval with respect to a Section 202 rule following the outline of the Commission's March 20 News Release, *if* such a rule is ultimately submitted for Congressional review.

Incremental Pricing and Deregulation

Before turning to their specific reasons for recommending Congressional veto of the Commission's proposed Section 202 rule, the Groups wish to emphasize that their opposition to such a rule and to Title II incremental pricing in general does not stem from opposition to higher gas prices *per se*. To the contrary, the Groups strongly favor deregulation of natural gas and, thus, fully expect that their gas bills will rise as the market comes into balance. What they strongly object to, however, is a scheme which contemplates that they should bear the full weight of higher wellhead prices while other gas consumers are insulated from such price increases.

The Groups believe that all gas consumer classes should be faced with correct price signals. Incremental pricing under Title II sends wholly misleading price signals to non-industrial users while wreaking havoc with industrial users and with the economy generally. Rolled-in pricing, on the other hand, sends comparatively truer price signals to all users, and, as supplies of old, relatively inexpensive gas are depleted, these signals will gradually indicate actual gas replacement costs. In the Groups' view, the best way to move from regulated prices to deregulated prices is through phased deregulation with rolled-in pricing. If it is important that the industrial sector be faced with correct price signals in order to discourage waste of valuable resources, it is equally important that other gas consuming sectors be faced with the same such price signals.

Industrial gas users and others supported deregulation of wellhead prices on the assumption that higher prices would elicit additional gas supply and eliminate the uneconomic demands (and consequent supply shortages and curtailments) created for gas as a result of artificially-low regulated prices. The industrial sector continues to support deregulation and is more than willing to bear an equitable share of the resulting higher gas prices. It is decidedly unfair, however, to force industrial consumers to bear a disproportionate share of higher wellhead prices while relieving other gas consumers from bearing their fair share of these price increases. Industrial gas consumers are emphatically not the sole beneficiaries of increased gas supplies. New gas supplies are obtained (and high new gas costs incurred) for the benefit of all gas consumers on any given system. All gas customers on a system receive an immediate benefit from the addition of a new supply -- as a result of both a higher measure of protection from curtailment and a reduction of unit fixed costs. Thus, all consumers should share in the higher costs of new gas supplies; it is patently unfair to concentrate such costs on a single consumer class.

Two principal objectives of Title II were stated to be "market ordering" and "price shielding". I would like now to address each of these in some detail:

"Market Ordering"

Incremental pricing will not act to prepare the gas market for deregulation. Whatever may have been perceived at the time the NGPA was enacted, it has since been demonstrated clearly that incremental pricing cannot achieve any market ordering aim. Everyone, of course, believes that the transition from price regulation to deregulation should be made as smoothly as possible -- without harmful market disruptions. However, incremental pricing is inherently incapable of providing the hoped-for transition. It will neither order gas markets nor provide an "orderly price path" to deregulation. It will instead perpetuate the market distortions caused by price regulation in the first place and will result in new and even greater distortions in the economy.

Many parties have commented on the market ordering potential of incremental pricing. Notably, the Department of

Energy's own analysis of FERC's original Phase II proposal concludes that it would "not make a significant impact on the market instabilities" in the transition to decontrol. Concerned itself about the issue of orderly transition to decontrol in 1985, DOE concludes that the "FERC proposal will have little effect on this issue." */

In addition, after five regional hearings and consideration of hundreds of comments on its original proposal, the Commission itself has concluded that "the market ordering purpose of Title II is unlikely to be achieved by expanding incremental pricing beyond industrial boiler fuel users." **/ On the basis of the voluminous record before it, the Commission has determined that the operation of incremental pricing under Title II could cause the alleged deregulated gas price "spike" and market imbalance with which Congress was concerned when it passed the NGPA to be "exaggerated, rather than attenuated."

In addition to those of DOE and FERC, the study prepared by Jensen Associates, Inc. shows clearly that Title II cannot achieve market ordering goals. The Jensen Report explains how the alternative fuel cost ceiling (or "fuel cap") provided for in Title II itself eliminates any potential which incremental pricing might have to remedy perceived market imbalances. In periods of relatively short supply, the fuel cap prevents price from acting to dampen industrial demand; as industrial users subject to incremental pricing reach the fuel cap, their alleged ability and their incentive to induce pipeline suppliers to refrain from bidding up the price of gas disappears entirely. Knowing that they will not be priced any higher -- if the federal regulations work as intended -- and that additional high-cost gas increments will be absorbed by users not subject to incremental pricing, the non-exempt industrial user will have no reason to attempt to restrain pipeline gas bids.

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*/ Technical Staff Analysis, submitted by the Office of Policy and Evaluation, Department of Energy, in FERC Docket No. RM80-10 (Feb. 8, 1980).

**/ "Summary of Commission Discussion on Phase II Congressional Submittal," at 13-14 (hereafter "FERC Summary").

The requirement that incremental pricing surcharges be passed through to non-exempt industrial facilities also prevents the market from being "ordered" when gas supplies are in surplus. In a free market, a supplier would naturally reduce prices in order to dispose of his surplus supplies. However, as the Jensen Report explains, under incremental pricing a non-exempt user must pay surcharges (potentially up to the fuel cap) regardless of the current relationship between supply and demand. Consequently, the gas supplier cannot reduce his prices to non-exempt users in order to dispose of surplus gas. Thus, supply and demand remain out of balance.

Incremental pricing will not act as a transition mechanism to afford consumers time to adapt to higher gas prices. Implementation of incremental pricing, instead, results in abrupt and substantial increases in gas rates to industrial users. Ironically, while intended to avoid market disorder later during the deregulation process, incremental pricing is beginning now to damage and distort not only the natural gas market, but also other consumer product markets. At the same time, no transition will be experienced by those not subject to incremental pricing because they will continue to be protected by Title II even after deregulation.

The disorder created by Title II does not even permit reliable projection of the quantitative cost impact of incremental pricing surcharges, let alone the cascading effects on the prices of consumer goods. The surcharge ceiling prices published monthly by the Energy Information Administration (EIA) have been changing radically -- with the figures originally published for April having just been revised dramatically. EIA's apparent inability to perform its functions under the incremental pricing rules, and non-exempt users' consequent inability to predict what gas ceilings and surcharges will be from one month to the next, are making business planning all but impossible. When this problem is added to the many others arising out of the incremental pricing scheme, some users would even prefer to pay a few cents more per MMBtu for oil than live with the uncertainties and administrative expenses associated with staying on gas.

In sum, "market ordering" cannot be achieved through incremental pricing under Title II, and it most certainly cannot be achieved or even furthered through the broad Phase II expansion contemplated by the Commission. To achieve an orderly transition to deregulation in 1985, the most efficient and equitable course lies in repealing incremental pricing altogether -- including Phase I -- and returning to rolled-in pricing of natural gas. At the very least, Congress should restrict the applicability of incremental pricing to its present scope under Phase I. Gas demand is being dampened already and will be progressively more restrained if all gas users are faced with the same gradually-increasing gas price signals.

The "market ordering" potential of Title II has been thoroughly and soundly criticized and contradicted. The Groups respectfully urge Congress to bear this critical fact in mind when considering both the appropriateness of the Section 202 rule submitted to it by the Commission and the continued appropriateness of Title II itself.

"Price Shielding"

The other stated goal of Title II is to shield residential, commercial, and certain other consumer classes from the higher gas rates resulting from phased decontrol of wellhead prices. Of course, the threshold question with respect to this aim is whether such "shielding" is today a desirable energy policy goal. As previously stated, the Groups' view is that it is not; each consumer class should be responsible for bearing the costs which it imposes upon a utility system; utility rates should not be established so that one consumer class is subsidized by any other class. While this principle is fundamental to traditional utility ratemaking, it is all the more compelling in today's energy climate in which it simply makes no sense to discourage conservation through artificially-low rates to selected consumers, while at the same time forcing uneconomic levels of "conservation" by other consumers through artificially-high rates. As stated, the Groups believe that all users should be faced with the steadily-increasing prices which result from the rolling-in of progressively higher percentages of deregulated gas costs. */

Beyond the question of whether such subsidies represent sound energy policy is the question of whether Title II in fact advances the aim of "price shielding." In this regard, the Groups wish to commend to the Subcommittee's attention two

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*/ In the FERC's hearings on Phase II of incremental pricing, Northern Natural Gas Company testified that in 1981 old, relatively low-priced gas volumes flowing in its system will represent approximately 50% of its total supply volumes, but only 30% of its total gas supply costs. In 1985, the volume of low-priced old gas (still under regulation) will have dropped to approximately 35% of Northern's total supply, but it will represent only about 10% of its total gas supply costs. FERC Docket No. RM80-10, Jan. 30, 1980 (afternoon), transcript at 38.

particularly telling statements contained in the Commission's discussion of its proposed Phase II submittal:

> "The record indicates that incremental pricing can advance the Congressional objective of price shielding. However, the Commission also believes that the measure and speed by which price shielding occurs must be tempered by equity and economic considerations. Too large or sudden a shifting of costs from exempt to non-exempt users could create serious industrial disruption.
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> * * *
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> ". . .[T]he Phase II submittal to Congress should point out that incremental pricing provides shelter to all high priority users, regardless of their economic need for this or any other type of subsidy. Other mechanisms might more successfully transfer assistance to those low income families in need of relief from rising gas costs. However, such mechanisms are not contained in Title II." FERC Summary, supra, at 15, 16.

In the first statement quoted, the Commission gamely concludes that incremental pricing can indeed advance the aim of price shielding, but the inquiry cannot end there. Congress' important general concern with the cost effectiveness and justifiability of regulatory programs stems from its wise recognition that the benefits to be derived from any given program should justify that program's economic and social (including administrative) costs. In light of this criterion, the findings of both FERC and DOE are compelling:

> -- FERC estimates that, under Phase I, the typical household that heats and cooks with

> gas is receiving a rate benefit of $6.50 per year or $.54 per month ($.05 per Mcf). Under the proposed Phase II, the same household would receive a benefit of $16.90 per year or $1.41 per month ($.13 per Mcf). The benefit from Phases I and 2 combined total $23.40 per year or $1.95 per month ($.18 per Mcf). */
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> -- According to DOE, if the Commission were to adopt its originally-proposed Phase II program -- including the three-tier fuel cap -- the reduction in the typical homeowner's gas bill would amount to only $2.67 per month in 1980, $4.50 per month in 1984, and $1.83 per month in 1985. These are the maximum potential savings which would be realized from incremental pricing, assuming that Title II were to work exactly as intended -- i.e., without loss of industrial load and without the distortions introduced by State incremental pricing plans (as discussed below).

This, then, is the benefit which FERC and DOE expect to result from incremental pricing. While the Groups believe that these numbers are inflated -- due to the agencies' failure to take a number of key factors into account -- it is compellingly clear, even on the basis of these projections, that the potential savings to exempt consumers from incremental pricing are simply not worth that scheme's inflationary impact on the prices of consumer goods, its effects on oil imports, its adverse impacts on utility revenue stability, and its staggering implementation costs.

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*/ Cities Service Company reports that, for the first 10 months of 1980, the projected rate benefit to exempt consumers on its gas system will be $.05 per Mcf, the same as calculated generally by FERC.

Perhaps most ironic is the fact that the short-term benefits of incremental pricing are so slight as to be imperceptible to the intended beneficiaries. For example, Cities Service Company anticipates a $.35 per Mcf increase in its overall delivered cost of gas to its customers -- including residences -- during 1980. Thus, even assuming incremental pricing were to work perfectly, homeowners who heat and cook with gas will not see any reduction in their gas bills. They will feel no "shielding" from higher prices; they will perceive no benefits from incremental pricing; under FERC's calculations they will still see a $.30 per Mcf increase in their gas bills during Phase I and a $.17 per Mcf increase during Phase II. Beyond that, they will also see the prices of cars, building materials, insulation, glass products, food, clothing, and other consumer goods increasing. And beyond that, if, as has already begun to be experienced, gas utilities lose industrial load to oil sellers who are actively undercutting the posted gas ceiling prices, these same homeowners and other exempt consumers will find their gas bills increasing dramatically as they become responsible for substantially larger percentages of the utilities' high gas costs and fixed costs of doing business. In short, the burden of rising energy costs upon low-income consumers will not be alleviated or even perceptively lightened. Instead, it is more likely that, overall, they will be economically worse off than if incremental pricing were never adopted.

The second point quoted above from the Commission's Summary is that incremental pricing "provides shelter to all high priority users regardless of their economic need for this or any other type of subsidy." What little short-term benefit may be derived from Title II, then, is not even focused on those consumers who really need it. Like other "rate reforms" (e.g., lifeline rates) which encompass subsidies, Title II makes no distinction on the basis of financial need. In contrast with such unfocused proposals, numerous energy assistance programs are currently in effect at the federal, state, and local levels; these and other programs administered through the present welfare system can more effectively target assistance to those actually in financial need.

Also in the context of weighing the costs and the benefits of incremental pricing, it must not be forgotten that, at best, even the minuscule and short-lived benefits of incremental pricing accrue to less than half of the nation's residential consumers. Millions of American families who receive their gas from the intrastate gas pipeline system, who use electricity, oil, propane, or another fuel for heating, or who do not pay their gas bills themselves (i.e., renters) will receive no subsidies whatsoever for their fuel bills. In fact, these consumers will be subsidizing the residential gas users on the interstate gas system because they will be paying the higher costs of manufactured goods with no offsetting benefit -- a double penalty. Insofar as gas consumers already pay comparatively less for energy than do their neighbors who heat with other fuels, it seems particularly ironic that a program should be developed to subsidize these already-favored consumers at the expense of other consumers.

The concentration of new, high gas costs on industrial users cannot help but have adverse consequences for the economy. On the one hand, many industrial companies will be forced to pass the higher costs through to all consumers in the form of higher product prices for consumer goods. On the other hand, however, not all companies -- especially those threatened by foreign competition -- will be able to recover these higher costs by raising the prices of their products. For some such companies, this will mean lower profits, lower productivity, employment cutbacks, and increased difficulties for capital formation. For others, it will mean being pushed over the edge -- to the point of not being able to compete with companies served by the intrastate market and with companies located in Canada and Mexico, none of which are subject to the burdens of incremental pricing. The shutting down of such facilities, or their relocation to a more hospitable energy climate, could have profound consequences for gas utilities and the consumers they serve.

In sum, the "price shielding" benefits of Title II are cruelly illusory. In real terms, they are so negligible as to be invisible to that portion of the nation's consumers to whom they will accrue at all. More significally, however, when weighed against the massive and inequitable economic dislocations resulting from the program -- including the substantial costs of the Byzantine administrative mechanisms necessary to implement it -- the incremental pricing program simply cannot be justified. Congress should veto any attempt to broaden the program beyond its minimum scope when the Phase II rule is submitted and should do away with the program entirely as soon as possible -- before aggravating the impact on our already-troubled economy.

State-Level Incremental Pricing Plans

More than half the states have now taken steps to retain for themselves whatever short-term benefits might flow from incremental pricing, to relieve themselves of the administrative problems of Title II and, in effect, to shift to other states the burdens associated with it. They have done this by ordering their local gas distribution companies to increase gas rates for non-exempt users automatically to the alternative fuel price for their area. The distribution companies then report to their supplying pipelines that they are unable to absorb any Title II surcharge. These plans are known as "zero MSAC" plans inasmuch as they permit a distribution company to report to its suppliers that its "maximum surcharge absorption capability" (MSAC) equals zero.

While exempt gas users in a zero MSAC state may enjoy a short-term benefit if the surcharge revenue retained within the state is used to offset their rates, they are the only users who might possibly benefit from the state's actions. Non-exempt users in the zero MSAC state are priced automatically and inflexibly at the alternative fuel ceiling even though the federal plan contemplates that such users may well be priced below the ceiling. Nonexempt users in other states are forced to bear a higher percentage of the pipeline's incremental gas costs because the zero MSAC states are capturing the extra revenues for themselves. And once the pipeline's incremental costs exceed the non-exempt users' ability to bear them, exempt users in the states without zero MSAC plans -- and even those in zero MSAC states served by utilities without industrial customers -- will find their rates increasing faster than would be the case if all non-exempt users were bearing their share of the pipeline's incremental gas costs.

The state zero MSAC plans thwart Title II in two ways. First, such plans expose some exempt users to higher rates than they would pay if all non-exempt users were contributing to recovery of the pipeline's incremental gas costs. Second, the "leverage" which non-exempt consumers are alleged to have to force pipelines to avoid high gas acquisition costs -- already shown to be dubious under Title II -- is absolutely non-existent under state plans which price such consumers rigidly at the ceiling level. In addition, insofar as the state plans result in exaggeratedly-low rates to exempt users in such states, these users receive especially distorted gas price signals and a strong disincentive to conserve.

States have always had the authority to institute some form of incremental pricing at the retail level; however, few implemented this ratemaking scheme prior to the enactment of Title II. Now, because of the sharp disadvantages inherent in Title II, over half of the states have distorted their ratemaking practices solely to counteract the adverse effects of the first phase of Title II. Many states have even specifically tied their zero MSAC plans to the existence of Title II and will terminate them upon its repeal -- demonstrating clearly the non-voluntary nature of the states' adoption of such plans.

The adverse effects of Title II which the states are seeking to avoid will be further exacerbated during Phase II if the Commission proceeds to adopt a Section 202 rule applicable to all industrial users. While it is true that many states have technically limited the effectiveness of their zero MSAC plans to the period of Phase I, it is unrealistic to assume benignly that the states will not re-adopt such plans for the period of Phase II if such action is necessary to make the best of a bad situation. For example, even some state plans containing such a "sunset" provision also recite that they will serve as the model for whatever the state may adopt in response to the federal Phase II. It is unrealistic to believe that the states will not do what is expedient, and, if any state served by a pipeline adopts a zero MSAC plan, it will be expedient -- indeed imperative -- for other states served by the same pipeline to adopt zero MSAC plans in self-defense.

Congress could not have foreseen the distortions of traditional utility ratemaking resulting from the states' response to Title II. In the absence of a Commission prohibition on adoption of zero MSAC plans (which it may or may not have the legal authority to impose), only repeal of Title II can remedy these distortions and restore natural gas ratemaking authority to the states, where it was before Title II was enacted and where it properly belongs.

Reassessing "Social Judgments"

In announcing the outline of its proposed Section 202 rule, the Commission determinedly avoided any appearance that it might be "second-guess[ing] the social and economic judgment that the Congress made when it enacted Title II." FERC Summary, at 4. Chairman Curtis saw the Commission's job as "more limited than that" -- *i.e.*, limited to bringing technical expertise to bear on designing a program which would best meet Congress' 1978 goals in enacting incremental pricing. Commissioner Hall echoed that sentiment:

> ". . . I recommend the [submission] to Congress [of] a Phase II rule without any formal Commission recommendation as to its disposition, because it seems clear that a Phase II rule can carry out at least some of the Congressional objectives underlying Title II. Whether

> the Congressional goals are still important and whether the degree of achievement is sufficient to justify the effort depends on social judgments about the equities that Congress is better equipped to make. Moreover, Congress did not ask for our judgment on these issues and I believe that the policy decisions required are not ones on which this Commission, as a body, can claim special authority or expertise." (FERC Summary, at 17-18).

Notwithstanding their considerable respect for the Commission and its Staff's diligent efforts in the many incremental pricing proceedings, the Groups vigorously disagree with the Commission's assessment of its responsibility under Section 202. The "social and economic judgments" made by Congress in Title II with respect to "market ordering" and "price shielding" were made only to the extent of Section 201, i.e., to the extent of the mandatory coverage of boiler fuel uses. Beyond that point, however, the framework created by Congress in Title II reflected its uncertainty as to the wisdom of applying incremental pricing. Consequently, in the Groups' view, Congress instructed the Commission to make its own first cut at the decision as to whether the scope of incremental pricing should be expanded. In making that decision, the Commission was charged to take into account not only the then-stated legislative purposes of Title II, but also the broad public interest as it would actually develop during the subsequent year and a half. On this basis, the Groups have urged the Commission to exercise its delegated authority in the overall public interest after comprehensive review and analysis of the options open to it and of the potential impacts of choosing any one of those options. */

The Commission, however, apparently did not agree with the Groups' view of the scope of its responsibility under Section 202. Instead of exercising its informed discretion to recommend to Congress, as its surrogate, what the appropriate scope of Phase II should be, the Commission proposes simply to adopt a rule which ignores the overwhelming adverse record developed in the rulemaking and which relies only on criteria which Congress itself foresaw might not even be relevant by the time the Section 202 rule was to be implemented.

Thus, the Commission apparently intends to do nothing more than submit a broad Section 202 rule, decline to evaluate the current vitality of the purposes sought to be achieved by that rule, and decline to recommend to Congress even whether or not the rule should be vetoed. In short, the Commission is performing a ministerial task -- doing only what it erroneously believes Congress expected it to do. Congress' surrogate having thus declined to act, it remains for Congress itself now to reassess the appropriateness of the economic and social judgments which it made almost a year and a half ago.

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*/ Importantly, the Commission has also failed to comply with the requirements of the National Environmental Policy Act that an environmental impact statement be prepared and made available for public comment with respect to its proposed incremental pricing regulations.

The Commission has stated quite clearly, that, in effect, the incremental pricing ball is now in Congress' court. The Commission will not go beyond what it perceives to be the limited role it has been instructed to play. It is, therefore, up to Congress now to send a message back to the Commission, stating its recognition that circumstances have indeed changed dramatically since 1978, that incremental pricing cannot in any event achieve "market ordering", that the benefits of incremental pricing to its intended beneficiaries are, even under the best of circumstances, negligible and invisible, that the program abounds with distortions and inequities, and that the likelihood of serious economic dislocation and severe harm to the nation's economy is far greater than was realized at the time the NGPA was enacted. If the Commission does not believe itself authorized to bring its own informed judgment to bear, the Groups respectfully urge that it is up to Congress to recognize that the overall public interest demands action:

> (1) Congress should, at minimum, veto any Section 202 rule which expands the scope of incremental pricing beyond the mandated statutory minimum; and
>
> (2) Congress should, as expeditiously as possible, proceed to pass H.R. 5862 and S. 2392 to repeal Title II in its entirety.

Conclusion

The Process Gas Consumers Group, the American Iron and Steel Institute, and the Georgia Industrial Gas Group sincerely appreciate this opportunity to appear before you today. Incremental pricing has long been of deep concern to these Groups, and it is becoming a matter of growing concern to more and more consumers across the nation. We respectfully urge the Subcommittee and the Congress to consider carefully the points which we and other parties are raising with respect to Title II. We are eager to respond to whatever questions you may have with respect to our position favoring the limitation and repeal of incremental pricing.

Thank you.

April 3, 1980

Mr. DINGELL. Thank you very much. The Chair advises he will recognize his colleagues on the committee in the order of their appearance. The Chair does advise this is not a hearing on any particular piece of legislation, including legislation to modify the Natural Gas Policy Act or to in any fashion deal with any of its titles, including title II on incremental pricing.

The Chair will recognize first for 5 minutes his friend and colleague, Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman. Gentlemen, you can either respond in turn or if one response satisfies the rest of you, respond as you will or do not respond.

Our economy is in a fairly serious condition, I should say a very serious condition, as a result of its unacceptably high levels of inflation and declining industrial productivity, as some of you have noted. What do you see as the impact of the Commission's proposed phase II incremental pricing rule on industrial productivity, capital formation, and our ability to compete with foreign industry in specific terms with reference to your own industry and the prospects of employment, unemployment, expansion, loss of market share, and so forth?

Mr. Salvino. I cannot respond to specific industries as I don't represent any specific industries in the utilization of gas. But, I can respond to the lack of competitiveness or loss of competitiveness.

It is interesting, for example, that the Canadians charge $4.47 at the border. When that gas is moved through the pipelines to get to the city gate, we are talking about $5 or thereabouts while at the same time they are charging their own industrial consumers in Toronto something like $2

So, in effect, they are creating a situation where they are making U.S. industrial use of gas noncompetitive and improving their competitive position. It would seem that this has to say the auto industry, if parts are being made, and they are, a good part of the cost of that would be heating or using gas for processing. It would seem to be a significant advantage in making them in Toronto rather than Detroit, so you are exporting jobs, in effect.

It is very important we keep our industrial prices as competitive as possible and not to the No. 6 level or what have you.

Mr. Brown. What you are saying is that Canadians are subsidizing their industry by the pricing of their gas and the domestic U.S. industry is being penalized or would be penalized because of the incremental pricing provision?

Mr. Salvino. Absolutely.

Mr. Brown. Any other comments?

Mr. Miller. Mr. Brown, I really don't know how to judge the economic impact on the steel industry because I don't know what assumptions we have used. I have done some calculations for one of the steel divisions within Armco. My assumptions were that we would use the April published price, cap price; my assumption was that we would use as much gas under incremental pricing as we did in the year 1979.

On that basis that particular division would suffer cost increases of about 25 percent of its product for the year. This is in a year that was pretty good for the steel industry. At the same time, that particular division only made 2.3 percent on the sales dollar. If you take a quarter of that, you are down to less than 2 cents on a sales dollar which is not a very good business.

Mr. Brown. It would go down about 1.7, I guess.

Mr. Miller. 1.7, 1.8.

Mr. Brown. Armco is one of the more successful steel companies in the United States. Some have not done quite so well in their profit position because they have closed plants in other parts of Ohio.

Any other comments?

Having lived under the first phase of incremental pricing for 3 months, what new administrative burdens have arisen as a result of the program? Any specific examples?

Mr. Salvino. There is one in the Chicago area or in Illinois, the EIA price that was issued would have caused an increase in the price of gas and before it was even to be made effective they retracted it because it was out of line. So, they are having great difficulties in administering the proper price, that is what is the price for oil, No. 6 oil in the area.

Mr. **Brown**. Let me ask one other question in that regard. The Natural Gas Policy Act was enacted in 1978. Since that time oil prices have increased by nearly 100 percent. We currently have a natural gas surplus. Does this change the basic premise behind incremental pricing?

Mr. **Salvino**. Certainly, it has a lot to do with why conditions are different and why you don't theoretically need the protection that was built into the incremental pricing. With a gas surplus situation, why would a pipeline go out and pay an excessive price, if that is the theory behind protecting the market so to speak?

All of those matters that pertain to market ordering do not apply in a situation where you have a surplus. They may apply if there were a serious shortage.

Mr. **Brown**. Mr. Gooch has had a little experience with market ordering historically. Could Mr. Gooch comment?

Mr. **Gooch**. I wish you had not asked me.

Mr. **Brown**. I wish I did not have to ask.

Mr. **Gooch**. To be candid with you, sir, speaking personally I don't know whether we are in a situation of shortage or abundance in gas supply. So, I cannot answer the question based on that. There was a hearing yesterday at FERC which hopefully shed some light on that. So, I really don't think I can respond to the question.

Mr. **Brown**. Take a couple more seconds to explain your answer to explain why a student of the gas industry, as you are, does not know whether we have a shortage or abundance.

Mr. **Gooch**. I am sorry, sir. I perhaps misspoke. I was looking toward 1985. The only time I think that any argument can be made with respect to market ordering would be after 1985. I don't see any possibility of its having anything to do with market ordering before 1985. I was talking about projections for 1985.

Mr. **Brown**. My time is up. I will let you stop at that, but I wish you would expand a bit on that answer, too.

Mr. **Grenier**. Could I expand on that question for a minute?

Mr. **Dingell**. Certainly.

Mr. **Grenier**. Mr. Jensen's study reveals very clearly that the assumption under which the Natural Gas Policy Act was a real supply crunch in the natural gas market and a relatively benign oil supply with relatively stable prices. In point of fact, these assumptions were all proven wrong by subsequent analysis.

Mr. Jensen's critique and also in oral testimony has pointed out very clearly that, in fact, the markets were much closer in balance in November 1978 than anyone suspected. There was not the great pent-up demand in the interstate market waiting to be saved by pipelines rushing down and grabbing all the intrastate gas.

In point of fact, if there had been total deregulation at that time, there would not have been severe disruption. The market was just about in balance. That was one assumption that clearly has not panned out to be correct upon subsequent analysis.

Another assumption was relative continuing stability of oil prices, therefore, only marginal burdens imposed on industry on account of incremental prices. That assumption has also proven to be totally erroneous since oil prices have doubled within a year.

I think under these circumstances and, therefore, the socioeconomic judgment under pending title II should be reexamined.

Mr. DINGELL. Thank you. The Chair is going to ask one question of Mr. Gooch. Mr. Gooch, I have had an opportunity to observe your labors over the years. I have observed you are a man with remarkable talent. You said something that intrigued me. You said that you don't feel that it is of great urgency that we have incremental pricing as a market ordering mechanism at this time.

You indicated in your comments that you thought the time that it might be necessary would be in 1985. Would you expand on that comment?

Mr. GOOCH. These are my personal views, Mr. Chairman.

Mr. DINGELL. They are valuable. That is one reason you are here.

Mr. GOOCH. I am not saying in my personal view that a market ordering device is needed after 1985.

Mr. DINGELL. The time prior to 1985?

Mr. GOOCH. I am starting with the proposition after 1985. I am not saying that one is or is not needed.

Mr. DINGELL. In fact, we don't really know?

Mr. GOOCH. That is my problem.

Mr. DINGELL. We actually don't know what the situation will be in 1985?

Mr. GOOCH. That's correct.

Mr. DINGELL. In 1985 it is within the realm of possibility that a market ordering device could be desperately needed?

Mr. GOOCH. That is true.

Mr. DINGELL. If we repeal the statute at this time instead of dealing with the question of whether or not to implement phase II or to exercise the congressional veto, we may leave ourselves without a market ordering device that might be of immense value by the time we come to 1985?

Mr. GOOCH. No, sir, I don't see it that way. Let me try very hard to say why I don't see it that way.

First of all, with respect to the rule two type issues for the feedstock and the process users, I don't see that they will ever figure into a market ordering device because they are so dependent on gas.

Mr. DINGELL. I am referring to the statute and not rule two.

Mr. GOOCH. I misunderstood.

Mr. DINGELL. Deal with the statute as opposed to what the FERC has done.

Mr. GOOCH. If we look at title II itself and just talk to the boiler fuel aspects of it, phase I, there is an essential problem that I believe this subcommittee's staff report put their finger on back in November 1978 if my memory serves me right on the staff report and that is assuming the implementation of the phase I boiler fuel that the boiler fuelers would reach their cap before 1985.

If that is true, the whole market ordering mechanism on boiler fuel is out the window when 1985 comes because the boiler fuelers are already at the cap if your subcommittee staff report——

Mr. DINGELL. I must interrupt you here because it may be that we have a little problem. Right at this minute, the cap is tied to the price of residual fuel. I have done some checking on what is going on in regard to the residual market. In January 1980 the price for residual fuel oil was $28.75 per barrel; in March of 1980, it had fallen to $18.75 per barrel.

So, that cap has slid substantially downward.

Mr. GOOCH. Right, that is my point.

Mr. DINGELL. I tend to come to a different conclusion on that matter than you.

Mr. GOOCH. I am not for a minute suggesting I am correct. I am only saying what I think my opinion is. What I am suggesting is that I don't think you can equate necessarily the mechanism that was selected in title II as the only type of market ordering mechanism that might be appropriate.

I suggest that your own staff report back in November of 1978 pointed out the danger that if you view it as market ordering, the boiler fuel aspect of it as market ordering, and if the cap is reached before 1985, then it no longer can serve as a market ordering device. I suggest to you that is what has happened.

Mr. DINGELL. Of course, we have no way of knowing yet whether the cap is going to be reached or whether the cap will shift by 1985 because it is a cap which is tied essentially to the lowest priced alternative fuel.

Mr. GOOCH. Yes, but I suggest to you that the No. 6 oil will continue to be overriding because of the relatively small number of boilers that will be on fuel oil. I further suggest to you that by limiting the universe of boiler fuelers to only the industrial sector and not the utility sector and other users, that the efficacy of title II as a market ordering device will be of limited effectiveness at best.

Mr. DINGELL. The Chair thanks you. The Chair is going to recognize his colleague, Mr. Swift.

Mr. SWIFT. Thank you, Mr. Chairman.

Mr. Merrels, you indicated that you have submitted a much more detailed statement, so you may have this information contained in it. In your statement you said ironically the proposal by FERC will hurt the very segment of consumers it is intended to help.

Would you explain why you think that is the case?

Mr. MERRELS. I think there are several aspects to that. First of all, as to the industrial users that can switch, if they do switch over to another fuel, such as fuel oil, they will leave on the pipeline the increased cost of gas. But of equal importance, the fixed charges for operating that pipeline have to be spread among the customers that are left on that pipeline.

The other difficulty that I see, my own company and other process users, are captive to natural gas because we do not have a substitute that could be. These same consumers, in the case of insulation, to be very specific, would have to pass along the premium price that we would pay in the form of the cost of the finished product which again is pointed toward the consumer.

In this case it is particularly disruptive of the efforts of conservation because you are charging more for a product to go to a consumer whose energy costs, potentially, at least initially, are subsidized which I think is detrimental to conservation. If it swings the other way they get both of these costs.

Mr. Swift. As you use the term consumer, are you talking about both residential consumers as well as certain types of industrial consumers?

Mr. Merrels. Certainly the residential, but we also serve the commercial and industrial market. Primarily when I said the parties who are attempted to be protected, I refer specifically to the residential.

Mr. Swift. It seems to me that one of the basic arguments that the panel is making is that the value to the consumer is going to be very marginal anyway. Is that correct? I believe in your statement you said negligible if not invisible.

Mr. Salvino. I will give you some figures on that if you want. The March 1 heating cost for a typical Chicago six-room house to heat with gas would be $629 per year; to heat with oil $1,402 per year. The amount of savings for phase II of incremental pricing would amount to $15. Now, you are adding a $15 savings to a price that is——

Mr. Swift. What you are saying is that if you were to spread these costs over all residential people——

Mr. Salvino. It is minimal. On the other hand, because you are talking about hurting industrial prices, it does have some impact on industrial prices.

Mr. Swift. The other part of the argument is, however, if industry has to assume these and pass it through, then the consumers of the products of those industries are going to have to pay so much more. It seems to me you are saying it will cost a little bit over here and huge amount over there. But you are still distributing the same cost.

Mr. Salvino. Except it is by different people. You are talking about subsidizing the natural gas users, but everyone is going to pay for it. The point I tried to make in my oral statement is that less than 50 percent of the heating users in the country are using gas. So, in effect, you are having a 100 percent in one form or another subsidize the $15 per year savings for the gas users.

Mr. Swift. It would seem to me that if, in fact, these increased costs are only going to be paid by the residential users of natural gas, and that is a very small amount, if, in fact, you send it back through to all the consumers in the country through other costs, you are spreading it over an even greater number of people.

If it does not cost you very much doing it over here, why is it going to cost people so much when you pump the other way in the cost of manufactured products? It seems to me that in your argument you are trying to have it both ways.

Mr. Salvino. It is a question of being competitive. Any industrial cost on the industrial side at this point runs contrary to making them as competitive as possible.

Mr. Grenier. The FERC staff's summary points this out. By the time you get through going through all the exemptions, only about half the volume of gas that would otherwise be covered by phase II will be covered, will be concentrated on the industrial sector. So, prices in that sector which cover manufactured goods on a broad scale will be going up.

Now whatever analysis you might make, whatever models you might make, I think the overwhelming odds are that the negligible amount of savings to the individual residential consumer in the interstate system may well be offset or even more than offset by the increased cost of manufactured goods to those very same people as well as putting the burden on other consumers who can get no benefit from incremental pricing because they are not served through interstate natural gas.

That is the point. It is not only the residences are exempt, the exemptions cover a wide swath of gas.

Mr. **Swift**. If you are spreading a given amount of additional cost, and you spread it over here it does not cost anybody very much more. When you spread it over here it still does not cost anybody much more.

Mr. **Grenier**. I think Mr. Salvino came up with some numbers. The phase II saving to the exempt customer would be 13 cents per Mcf. With phase II surcharging in, it would be 15 cents or more. You are bunching it up. That is the problem. It is just another nail in the coffin so to speak.

Mr. **Swift**. Thank you.

Thank you, Mr. Chairman.

Mr. **Dingell**. The time of the gentleman has expired.

The Chair recognizes the gentleman from Indiana, Mr. Sharp.

Mr. **Sharp**. Thank you very much, Mr. Chairman.

Mr. Salvino, I want to ask you if you believe, in fact, there is clearly more gas available since the passage of the act than there previously had been in the interstate market. In other words, has the act helped the supply situation in the interstate market?

Mr. **Salvino**. It freed up intrastate gas that was not available prior to that. It certainly has enhanced the effort to find more gas. There have been a number of pipelines in the last several months that have announced that their reserve life position has improved. So, I do think in part it was responsible for quite an improvement in gas supply.

Mr. **Sharp**. I can appreciate and understand some of the arguments on the question of the differential impact that this phase II thing might have. I guess I have a little difficulty with the argument coming from you and some of the others on the question as to whether we are doing some great damage to industry in this country by raising the price of natural gas because I would ask you, if you assume that, if we had taken your position which was to immediately deregulate new gas, if I understand the position, as well as I would assume you would allow rollover of other contracts and a whole series of things that affect old gas, don't you think the price of gas would be higher today, right now?

Mr. **Salvino**. Conceivably. Part of that, of course, is again you have the problem of—I wanted to say the OPEC situation in a sense. You get higher prices that are created there. So, it gives you more room. It is not entirely the fact that you can charge whatever you want. There is some competitiveness, as a matter of fact, electricity in a number of cities is cheaper than No. 2 oil. So, there are factors that would ameliorate the price rise.

Mr. **Sharp**. I guess I am not hearing you. Do you think the price of gas would be higher today if we had not passed the act and if we had taken your approach and passed immediate deregulation?

Mr. **Salvino.** I would have to agree with that. But, I don't know how much more it would be. I don't think it would be anything like No. 2 oil.

Mr. **Sharp.** I guess I just have trouble buying the argument that we should weep now for industry about the increase in the price of gas when, in fact, you were advocating a position a year ago that clearly would have taken the price higher.

I can understand and appreciate the argument as to what difference this phase II might have in terms of specific industries, specific pipelines and specific systems and whether or not on that basis I intend to try to calculate what we ought to do about it.

But, I guess I just cannot buy the argument from those who came in here—and you can always tell when you have natural gas by the size of the audience—that we have just got to be very sensitive to this.

This is the position I think our industry ought to understand, that much higher prices of gas were advocated to us just 2 years ago. Also, many of them supported the Krueger-Brown position on the House floor which I believe also included incremental pricing as a provision and recommendation to the Congress as one of the sensible ways in which we should work out the compromise on natural gas.

I hope you will appreciate that we are not all together fond of hearing how outrageous the U.S. Congress was in coming to some of these conclusions. That is just a personal pique of mine, having been through months and months of negotiation with the Senate on the issue.

Mr. Chairman, I just had to get that off my chest.

Nevertheless, I look carefully at the regulation on the veto and what impact phase II will have. We did the legislative veto into the process precisely because we knew that we did not know what the real impact would be until we got a specific proposal before us.

If the gentleman would like to comment.

Mr. **Merrels.** Congressman Sharp, I would have difficulty projecting the answer to your question on what we have today. But, I do think there is an excellent example we saw prior to NGPA in the intrastate market when we saw prices go up when the supply went down; when supply went up the price went down again with good market response.

This was not only in the gulf oil and gas producing States, but in States such as Ohio. I think that one of the elements that we just cannot judge is what is going to happen if those marketplace laws of supply and demand are allowed to operate. But, we have seen that happen and that is known. I would say during times of shortfall it would go up; in times of long supply, it would come back down again.

Mr. **Grenier.** I think there is quite a difference. Even if there were full deregulation 2 years ago that deregulation would have applied only to new gas, not to old flowing gas. It all would have been rolled in. The impact would have spread over a much wider base than the existing proposed for incremental pricing.

I suspect the impact on U.S. industry would have been far less than under incremental pricing.

Mr. Sharp. I certainly agree with your statement that the focus of that incremental pricing is on a select number of customers. That is one of my concerns with title II and its impact. But, I guess I have difficulty accepting your proposition on the deregulation.

Most of the proposals we saw were pretty wide open as to what cap on new gas and also we learned in the process the extraordinary number of contracts that were going to be fairly geared to new gas prices, those that were behind that way in the contract and those that were simply rolled over.

It is happening today under the gas policy. You know, 30 cent gas that is jumping to $1 and even $2.

Mr. Brown. Will the gentleman yield?

Mr. Sharp. I yield.

Mr. Brown. I will point out to the gentleman one of the historic facts. If we had delayed action at all, we would then have a free market in some of the gas and controlled management in the other gas. If we had not done anything, it would have looked very much as if the free market would have gotten below the controlled market price at that time.

That was the direction in which it was moving at that time. It has all been changed because it is now all a controlled market.

Mr. Sharp. You mean the prices were going to drop back to $1.42?

Mr. Brown. No; I mean the prices that would have been obliged by the reassessment of the controlled price of new gas would have gone above the $2 price which was the price of the intrastate market. The intrastate market was going down, but the new controlled price would have probably been above the free market price if we had kept going for a while.

Mr. Sharp. You know that situation would have changed immediately when that gas was able to flow across that State line. If we had not acted, we would be sitting here today debating that question and we would be short of gas in the intrastate market. However crude and crass and complicated that proposal was, it has made a difference in having natural gas in the intrastate market.

Mr. Brown. For now?

Mr. Sharp. For now and I suspect in the future.

Mr. Dingell. The Chair finds that all the testimony we are getting at this point indicates there is a considerable supply of natural gas in the intrastate market.

The Chair recognizes now his friend and colleague, Mr. Wirth.

Mr. Wirth. Thank you, Mr. Chairman.

I was wondering if the members of the panel might react to the next to the last paragraph in the chairman's opening statement. Let me read that for you if I might.

> Residential rates for natural gas have always been higher than industrial rates. Comparing the first and third quarters of 1979, when the wellhead prices for natural gas were higher because of the Natural Gas Policy Act, but incremental pricing had not yet been put into effect, the difference between the average rate to industrial and residential customers increased from 57 cents to $1.27.
>
> During this period, residential rates increased 98 cents, while industrial rates increased only 28 cents. At the end of the third quarter of 1979, residential users paid an average of $3.59 per Mcf, while industrial users paid an average of $2.32 per Mcf. Not surprisingly, during this same period, industrial gas consumption increased 15 percent, while residential consumption remained constant.

First of all, who would like to react to the question, one, is that a valid statement? Second, what comment might you have on that?

Mr. GOOCH. I would be pleased to start.

I have no doubt that it is a valid statement. I don't question that at all. Our suggestion is that you look instead and separate the distribution cost because one of the large elements of cost to the residential consumer is the necessity of bearing a large distribution system to get relatively small volumes of gas door-to-door throughout a city.

That does not cost that to get to the large industrial user. I suggest to you that if you use, as we chose to do, the FERC staff summary for comparison and look at the monthly reports NEIA order No. 725, which shows on an annualized basis the resale rate nationwide for interstate pipelines, you see that the wholesale rate hitting the city gate was, in November 1979, about $2.19.

Now, the average rate to the industrial who is a direct sales customer from the interstate pipeline firm was $2.31, which is obviously more than what was paid at the city gate.

Now, the FERC staff estimated that the industrial rate was about $2.60. Obviously, they have picked up some of the distribution charges in that. So, when you look at the burner tip I think it is fair to say that the residential pays more at the burner tip than the industrial.

I would suggest that the proper place to measure that, though, is at the wholesale level because the industrial should not be charged for that door-to-door distribution system to get it to the residential.

I suggest when you look at it that way that you will find that the industrial, the firm industrial, not the dump, interruptible industrial, but the firm industrial, is paying about the same or more than the residential.

Mr. WIRTH. When we debated natural gas pricing in 1977 and 1978, as I remember it, the general formula for the residential consumer was about 25 percent, about 25 percent was pipeline cost and about 50 percent was distribution and marketing cost. Is that accurate for that period of time?

Mr. GOOCH. I truly don't remember.

Mr. WIRTH. What is it now?

Mr. GOOCH. We could figure it out in a second if we accepted the FERC staff number of $3.58, I believe it was, as a rough guide and you took the $2.19 out of the EIA study. That would give you $1.40 for distribution cost of the wellhead price for gas from domestic producers that month averaged $1.41, from Canada and foreign sources, $3.40 an Mcf, giving an average of $2.39.

I told that wrong. It was $3.40 and $1.41 which would average out at $1.61. So, you figure, say, $1.61 for the cost of the purchase, the difference between that and $2.19 for the interstate pipeline and then $1.40 for the distribution system if you are going to use these rough numbers to get that percentage.

Mr. WIRTH. The point you would make in response to those figures is that one should compare the cost of the gas, the pipeline cost to the residential consumer, versus the cost of the gas and pipeline cost to the industrial consumer and leave out the local distribution cost?

Mr. GOOCH. Yes; or take it into separate consideration.

Mr. Wirth. Do any of the others have a reaction to that?

Mr. Grenier. I agree with what Mr. Gooch said. When you hear the statement that residentials pay more than industrials, that statement standing alone is truly meaningless in the utility analysis sense. The real analysis that has to be made on who is appropriately paying their fair share of the cost of the whole system is what rate of return is the utility earning from each class of customers.

We have seen consistently on the electric side and also on the gas side when cost of service studies have been made that the industrial sector, if anything, pays more than the average rate of return, maybe 120 percent, and residentials typically pay a lot less, maybe only 80 percent.

So, if there is any subsidization going on, it is the industry subsidizing the residentials through rate design. Now, this has gone on for years.

The groups that we represent firmly believe that rates ought to be based on the cost to serve each customer, they each ought to pay their own cost. How did that happen? The simple reason is that industries don't require as much of the distribution equipment.

In many cases, plants take gas virtually directly from the pipeline with a tiny piece of equipment owned by the distributor. Yet, they pay a large share of the distribution company cost although, in actual fact, the real cost is nearly zero. So, that in our view is the proper way to make the analysis.

Mr. Wirth. Do any others have comments?

Mr. Salvino. Currently in Chicago, the residential customer in cost of service, or determining the return on that service, is paying nothing toward profit or taxes. So, that industry and the other rate payers are subsidizing, in effect, the residential customers in Chicago because there is absolutely no contribution toward profit or taxes.

Mr. Wirth. Since you all remember——

Mr. Dingell. The time of the gentleman has expired.

Mr. Wirth. Thank you, Mr. Chairman.

Mr. Dingell. The Chair recognizes now his colleague, Mr. Corcoran.

Mr. Corcoran. Thank you, Mr. Chairman.

Aside from the congressional controversy that surrounded passage of the act and aside from the assumptions under which the act was passed, the thing that I think bears the focus of today's hearing is the phase II incremental pricing regulations that will be coming forward shortly. I know these regulations will be coming to the Congress pretty soon because FERC and the Department of Energy and others are now answering my mail a lot better than they did 2 years ago.

My concern is the inflationary impact of the decision that will be made by FERC in conjunction with the Congress this year.

Compared to the economic conditions that existed when the original act was passed, the economic conditions which exist today, especially in terms of inflation, are horrendous. It is my view, based on the mail I have been getting, based on the conversations I have had with industrial constituents, that this particular increase in cost for natural gas is going to bring about an increase in prices.

If I understand one component of inflation, it is the increase in price with the unit increase in goods or services, that is going to be a factor in terms of the consequences of this particular decision made by the Government.

So, I would like to ask, Mr. Salvino, whether or not the Chamber of Commerce has had an opportunity yet to survey its members to find out if they have been able to evaluate first the impact of phase I, second, whether or not there would be an increase in phase II, and third, whether or not those increased costs would simply be absorbed, whether or not the robber barons would have to dig a little deeper in their pockets and absorb that cost or whether it will be passed on to the consumer.

Mr. SALVINO. I do not think, in response, the chamber is making any type of survey, at least to my knowledge. I do think, however, in the second panel there will be a response as to the impact of phase I just during the very short period that it has been in effect. So, I think you will have an answer to that problem, at least a partial answer, as to what has developed.

Mr. CORCORAN. One of the other concerns that I have is the process and the mechanism in place in order to settle the ceiling. In your work at Peoples, of course, you come directly into contact with this all the time. I have heard some horror stories about the operation of the Energy Information Administration.

I just wonder what your experience has been and how you go about getting from the Government, ultimately through FERC, the price that you can charge your industrial customers. Can you tell us about that experience?

Mr. SALVINO. I would like to defer somewhat to the people on the next panel. However, I can go to the specific problem we had. I believe the EIA prices are published in the Federal Register. The published price that would have created the first increase above current industrial rates in Chicago—our rates are already at the No. 6 oil level, so to speak, because the State Commission has taken that action, the Federal regulations did not do anything to change that—but this would have been the first instance where an increase would have been necessary and we notified our industrial customers of this and there was some concern that they would have to switch.

Mr. DINGELL. Switch to what?

Mr. SALVINO. Switch to oil.

Mr. DINGELL. Which kind of oil?

Mr. SALVINO. No. 6, I believe, or No. 5. But there was no question they were going to switch in a matter of several days. Then we got a notice that the price had been reduced, so it made the situation moot. That is the confusion.

Our customers are confused, there is no question. They do not know how to plan for it.

Mr. CORCORAN. To give you a specific example, a company in Illinois known as Kelly-Springfield learned on the basis of a FERC announcement of March 20 of this year that the fuel ceiling for April would be $3.62 for our State and then late Friday on March 28, FERC revised its ceiling to a new level of $2.88 for Illinois.

In the meantime, however, Kelly-Springfield, in response to the price as first posted on March 20, had arranged to switch to an alternate fuel, which was in fact oil, and they were able to achieve a savings of about $25,000 for the period involved.

So, here we are very much dependent on foreign oil, trying to deal with the natural gas problem and having an effect which causes one specific company, not 10 or 15 years ago but just this past month, to switch to oil and to generate that kind of savings.

Then can you imagine—you probably can because you have been on the other end of the telephone call—can you imagine the response of that particular industry when they found out that FERC had subsequently revised its figures, gone back to $2.88? That is a strange way to do business.

Mr. SALVINO. Once you notify the industrial customers, they are well aware that the oil dealers are quite anxious to sell oil when they have a surplus as they appear to have now. They are quite aware of the competitive prices. It gets to be a question of what is the proper incremental price level. I do not think that procedure has been worked out to their satisfaction.

Mr. DINGELL. The time of the gentleman has expired. The Chair recognizes now the gentleman from Michigan, Mr. Stockman.

Mr. STOCKMAN. Thank you, Mr. Chairman.

I have to note at the beginning that since the bill that the gentleman from North Carolina and I introduced is only 13 words long, I am somewhat surprised at the depth of interest displayed in the room today.

I would like to go back to the theory that was being promoted by the gentleman from Washington which might be called the diffusion theory of inflation. That is, if you load all the extra gas cost on a very narrow segment of customers or users and they pass it through in their industrial product and it is then bought by millions of people in the marketplace, finally the extra cost will just disappear into insignificance.

It seems to me that is not really a correct analysis. We have to look at the equities. Usually the Democrat side is looking at equities and we are looking at inflation. I would suggest that maybe we should reverse that today.

The fact remains that if you look at the residential sector in terms of fuel use, you will find the guy with home heating oil at about $2.60 a thousand cubic feet; the guy heating with electric resistance, $8 or $10; and the guy with natural gas way down there at $3.50.

You are going to shield him for quite some time to come and thereby discourage him from making the investment in installation or retrofit that we are always talking about in this subcommittee and writing bills to promote, subsidize, encourage and regulate and in other ways stimulate, and then the guys on the other side of the equation, the 50 to 60 percent who use electric resistance heating or heating oil, who definitely need to insulate because they are faced with very high prices and strong incentives, are going to have to buy insulation which bears part of the cost of incremental pricing to the insulation maker.

How far can we contort or distort the equities in this whole process? You have perverse economic incentives and terrible inequities. Isn't that one of the arguments we are raising as we address the incremental pricing issue? I would be interested in any comments from the members of the panel.

Mr. MERRELS. Being one of those you were discussing, Congressman, I could not agree more with what you have said.

Mr. STOCKMAN. OK, then we will go on to another question.

Mr. SWIFT. Would the gentleman yield?

Mr. STOCKMAN. I will be happy to yield.

Mr. SWIFT. I am sure the gentleman from Michigan did not intend to misstate my point. However, I was not suggesting that this was all going to disappear somewhere. I was suggesting that they were saying it was all going to disappear somewhere. Would you care to address that?

Mr. STOCKMAN. Yes. It is not going to disappear. Costs do not disappear down the sink in our economy. They just get disguised. I think that is part of the whole effort. I am not sure it is productive to the whole economy.

Mr. SWIFT. I am happy to agree with the gentleman from Michigan.

Mr. STOCKMAN. Let me follow the point made by the gentleman from Illinois. Mr. Sharp raised a good point. If you had followed the advice of Mr. Brown and myself, we would have decontrolled in the natural gas completely; you would be facing a higher price.

I think we have another question here which has nothing to do with the pure economics of price or cost to users and it has to do with the fact that incremental pricing involves an administrative mechanism which is another one of those bureaucratic devices that will not fly, because we are tying the whole rate structure now to the price of a fuel which is inherently volatile, resid.

If we look down the road the next couple of years we see a declining demand probably for resid. We heard that yesterday at our hearings on another topic. We are going to have periods of crude excess, crude shortage. Resid is not only the bottom of the barrel in a physical sense but an economic sense as well.

You are easily going to have swings of $10 a barrel up and down depending on the state of the market and inventories. What steps are refineries making to retrofit and use more of the bottom of the barrel for nonresid products?

How in the world can thousands of industrial users out there, 50 State rate commissions, and all of the distribution companies and pipelines involved keep up in terms of revising their rate structure and charges every month with this kind of yo-yo target that is going to be moving you up and down at a rapid rate depending on the state of the market for a fuel that historically has demonstrated that same kind of characteristic and will be even more so true in the future?

Isn't that part of the problem, that this resid price is a yo-yo that will drive the whole system into great complication, waste, difficulties of compliance, not knowing what your costs are going to be?

And second, is the EIA price that is published necessarily the real transaction price in the market and won't that cause complications as well if the transaction price turns out to be a lot lower than the posted or published price?

It seems to me if I were a smart fuel oil dealer, I would get my posted price up and transaction price and steal the market from the natural gas companies.

Mr. **Miller**. The problem with the cap price is that the first 4 months of experience have told industry that they are going to have real trouble trying to live with that in the future. You cannot make any plans. You do not know what is going to happen in the next month.

For instance, in Ohio, the January price was $2.91. The February price dropped to $2.80, the March price was $3.06. The April price posted on the 20th of March was $3.63. That is a 25-percent increase. It has gone down and now it has gone 25 percent higher in the first published price.

When I got into Washington last night I understood that EIA has now established still another price for April.

Mr. **Stockman**. Could I ask you to follow up on that? Don't you also have seasonality in the resid price that may move contrary to the price expectations of process users and feedstock users who would expect a steady cost over time?

Mr. **Miller**. That is correct, sir.

Mr. **Dingell**. The time of the gentleman has expired.

The Chair recognizes now the gentleman from Texas, Mr. Loeffler.

Mr. **Loeffler**. Thank you, Mr. Chairman.

As a good American from Texas, I think this morning's exercise points out the futility of Government's effort to try to regulate a marketplace. There is no question in my mind that had deregulation occurred as the gentleman from Ohio, Mr. Brown, and the gentleman from Michigan, Mr. Stockman, advocated, we would not have the problems we are confronted with today.

I would like to ask a question of Mr. Crittenden.

I am particularly concerned with regard to the process and feedstock use of natural gas. For these uses, the industry is absolutely dependent on natural gas; there is no other alternative. Is there any conceivable way that incremental pricing will significantly conserve natural gas for process and feed stock use and, in turn, decrease the use of costly and vulnerable imported crude oil among other industrial users?

Mr. **Crittenden**. You mentioned at the end "among other industrial users." Do you wish me to address my answer to the petrochemical industry?

Mr. **Loeffler**. I would like you to address it to the petrochemical industry, first, because I think it is important that it be made part of the record that there is little you can do; and then, what effect will that response have on the entire industrial users as a group?

Mr. **Crittenden**. My answer must be limited to my knowledge of the petrochemical industry which, of course, is mainly my own company. I have some general knowledge. My answer is that there is in most cases of process or feedstock use of natural gas no substitution with other fuels or feedstock sources except by very remote, far out inconceivably expensive mechanisms.

Mr. **Loeffler**. What would those be?

Mr. **Crittenden**. I speak about, for example, very exotic fuels that can generate the very high flame temperatures, for example, that natural gas is capable of but which would be way too expensive to consider.

The answer then is no, I do not think that our industry in general would be able to reduce by conservation in the conservation sense. The chemistry of our processes requires a certain amount of raw material to make a pound of finished product.

When you have improved those processes to the degree that many in our industry have, there is very little left for conservation.

With regard to other industries I am not qualified really to address the question in that context.

Mr. **Loeffler**. Would anyone else on the panel like to respond? Clearly it is a question that is not that difficult to answer.

Mr. **Merrels**. Being basically a process gas user I would go along with the comment that there is not much to turn to. We do have the opportunity, although difficult in a short time period, to use propane. But you are talking of material that comes from the same hole in the ground or out of the natural gas stream.

Mr. **Loeffler**. What both of you are saying is that if the potential phase II implementation would include process and foodstock gas we have not accomplished a thing.

Mr. **Crittenden**. That is correct.

Mr. **Merrels**. I would like to take it one step further. I think if the process users are subjected to these higher costs as touched upon earlier, it is a diversion of capital and it is capital that conceivably could be used for conservation purposes, although I think industry has done a very responsive and responsible job on conservation.

The next steps of conservation—and I think there are some that can be done—the more you are trying to save, the more capital intensive they are. I would prefer to see if there is a choice and go, if at all possible, to further conservation by industry itself—this varies from manufacturer to manufacturer—than to have that capital diverted to a one-time deal that has no value to the country.

Mr. **Loeffler**. What would be the effect on loss of employees as a result of additional cost of feedstock or process gas if it were made a part of the so-called phase II? In other words, what are you looking at in reduced employees because of the additional cost of such gas?

Mr. **Crittenden**. Mr. Loeffier, we do not have that information for our industry as a whole.

Mr. **Loeffler**. Is it possible to get that and make it part of the record?

Mr. **Crittenden**. I will try to do so.

Mr. **Loeffler**. Mr. Chairman, I ask unanimous consent that that be made part of the record at this point.

Mr. **Dingell**. Without objection, it is so ordered.

[Testimony resumes on p. 98.]

[The following letter and attachment were received for the record. The biography referred to may be found in subcommittee files.]

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May 19, 1980

William Braun, Esquire
Counsel to the Energy and
Power Subcommittee
House Annex II
Room 3217
2nd and D Streets, S.W.
Washington, D.C.

Dear Mr. Braun:

During the hearing before the Subcommittee on Energy and Power on April 3, 1980 pertaining to the Phase II Incremental Pricing Rule, you and members of the Subcommittee expressed concern over the fact that residential rates for natural gas are higher than industrial rates. For example, in Chairman Dingell's opening statement it was noted that in the third quarter of 1979, residential users paid an average of $3.59 per Mcf while industrial users paid an average of $2.32 per Mcf.

During the hearing I pointed out to the Subcommittee that the differential between industrial and residential rates has historically existed because of the substantial difference in the cost of service to these categories of customers.

To assist in illustrating this point, I have attached the Statement of Mr. William W. Eyers, a Senior Consultant in the Public Utilities Department of the accounting firm of Deloitte, Haskins & Sells. Mr. Eyers has participated in all phases of rate and certificate proceedings before regulatory bodies on the state and federal levels and has frequently prepared rate design studies for these agencies. (See attached biography.) As Mr. Eyers' Statement demonstrates, rates on the retail level for natural gas are set on the basis of the costs attributable to the service of each category of customer. Industrial users fully pay for the costs of service attributable to them in their gas rates; the fact that rates to industrials are lower than for residentials reflects the differential in the cost of service to these different categories of customers. Indeed, as Mr. Byers notes, it is typically the case that industrial customers bear, in addition to their own costs, some of the costs attributable to service of residential customers.

If I can supply further information on these issues or be of any other help to the Subcommittee, please let me know.

Very truly yours,

Gordon Gooch
Attorney for the
PETROCHEMICAL ENERGY GROUP

GG/pd
6294-117
Attachment

INCREMENTAL PRICING - PHASE II

STATEMENT OF WILLIAM W. EYERS
ON COSTS AND RATES
TO THE ENERGY AND POWER SUBCOMMITTEE

I have been asked by the Petrochemical Energy Group to describe to the Subcommittee my experience with respect to the methods generally used by state regulatory commissions in determining rates for industrial gas customers. As I describe below, industrial rates typically reflect the full cost of service attributable to these customers. Rates for other categories of customers are not increased in order to bear costs attributable to industrial service. Indeed, in the usual case the costs attributable to residential and other customer categories are partially passed through in industrial rates.

The ratemaking process begins with the determiniation of a utility's total cost of service, rate base and return. When this has been done, the total revenue requirements can be determined and this amount, when compared with the expected revenue under present rates, indicates the increase in revenue that will be needed to provide the revenue requirements. After this has been accomplished, definitive rates for each of the customer groups can be designed.

A logical starting point in the rate design process is the determiniation of the costs incurred by the utility in serving its various customer classes. The customer classes today are in large part groups of customers that generally have similar usage and cost characteristics, for example, firm residential customers or firm industrial customers.

The objective of the cost study is to determine the costs incurred by a utility in serving its various customer classes. The study involves a determination of the nature of the costs incurred by a utility in serving its customers, and the manner in which they arose. In a study of this nature, return is considered a cost, and the rate of return is applied to the rate base applicable to each customer group to determine that element of cost.

A cost study is based on the operations of a particular utility. Thus, before a cost study can be made, one must gain a knowledge of the general nature of the utility's operation, its service area, and the types of customers the utility serves. This provides the background upon which the costs incurred by the utility can be analyzed. Typically, the classes used in a gas cost study are Residential, Commercial, Industrial General, Large Volume, and Interruptible.

The actual preparation of a cost of service study follows a number of logical steps. The first is to analyze and classify the costs of the utility in accordance with their nature and the manner in which they arise. The costs are found to be of two broad types: those that vary with the amount of gas purchased and sold and those that are independent of and do not vary with the amount of gas handled or sold. The first group of costs are called variable costs, and the latter group fixed costs. Most of the costs may be readily classified into one category or the other. In a few instances, a cost is found to be partially variable and partially fixed. In these few instances, the classification is made after a study of the relevant facts and on the basis of experience and judgment.

The fixed costs are found, upon analysis, to be composed of three separate kinds of costs. These are: costs that are determined by the capacity of the system; costs that are determined by the number and location of the customers on the system, and a group of costs that are fixed in nature but not a function of either the capacity of the system or the number or location of customers. In analyzing costs, it will be found in some instances that costs had been incurred for specific customers or customer classes and, in those instances, the costs are assigned directly to the customer responsible for incurrence of the costs.

The size or capacity of the system is almost inevitably determined by the maximum requirements of the firm customers. In most utility systems, the maximum firm requirements are expected to occur on a very cold day in winter. Consequently, the requirements of the customer on this day are used for determining the capacity of the system. Such peak-day requirements are also used to spread the capacity costs to the various classes of customers responsible for their incurrence based upon the percentages that these requirements by class are of the total requirements.*/

Certain of the fixed costs have been incurred because of the location or requirements of the customers. Where these costs are specifically identified, they are assigned directly to the customers responsible for their incurrence. Other fixed costs in this category are not incurred for any particular class, but are incurred as common costs. Meter reading is an example of this type of costs. These costs are incurred and measured by the number of customers in each class.

The variable costs are incurred for the customers in proportion to their annual use of gas, and are determined by the customers' use of gas.

Thus, three items, namely the Maximum Design Day Requirements (Peak-Day), the Number of Customers, and the Annual Sales, are used to spread the costs to each of the customer classes after making the direct cost assignments.

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*/ In many cases, there is a very small amount of sales that will be made to the Interruptible customers on a peak-day. This arises because of practical operating problems and the difficulty of having all customers turn off immediately upon being asked to. This fact must be recognized in developing the costs applicable to this class of customer. However, these customers are intended to be served and basically are served only when system capacity is not required by firm customers. Therefore, other than for this very small amount of capacity, no capacity is provided for Interruptible customers.

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The last step in the preparation of a cost study is to bring together in summary form the various costs incurred in serving each customer class. These costs can then be compared with the revenues under the present or proposed rates to show the relationship between costs and revenues.

Nevertheless, the costs incurred by the utility in serving its customers as set out in a class cost study are only one element to be considered in setting the actual rates or pricing the utility's products. Other factors that often are considered include:

- History of rates
- Competition
- Rates in other areas
- Governmental restraints
- Relative risks in serving various types and kinds of customers.

When all the factors bearing on the rate design are before the tribunal setting the rate, the revenue increase or revenue expected to be received from each class can be determined.

In my experience it has always been the case that the rates ultimately set for industrial customers reflect fully the costs attributable to those customers as determined by a cost study such as described above. The consideration of other non-cost factors typically has served as a basis to reflect costs attributable to non-industrial service, particularly residentials, in industrial rates.

For example, in a recent case involving Wisconsin Southern Gas Company (Docket No. 6710-GR-5), the Wisconsin Public Service Commission approved rates which reflect this. By reviewing the attached tabulation based upon statistics from this proceeding, it is clear that revenues to be generated by residential customers are much lower than the total cost of service for which they are responsible. Therefore, the firm industrial and interruptible (and to a small extent, commercial) customers must subsidize the residential customers by contributing revenues proportionately greater than their shares of cost of service.

WISCONSIN SOUTHERN GAS COMPANY

Comparison of Revenues Approved
with Total Cost of Service by Customer Classification

Docket No. 6710-GR-5

	Total	Residential	Commercial	Industrial	Interruptible	Other
Revenues approved by the rate order	$23,507,800	$12,552,900	$5,762,400	$2,614,100	$2,371,200	$207,200
Percentage	100.0	53.4	24.5	11.1	10.1	.9
Total cost of service for test year	24,029,300	15,063,800	5,208,600	2,020,900	1,736,000	
Percentage	100.0	62.7	21.7	8.4	7.2	
Revenue Excess [Deficiency]	$ [521,500]	$[2,510,900]	$ 553,800	$ 593,200	$ 635,200	$207,200
Revenue Excess [Deficiency] Expressed as a percentage of revenues approved by the rate order		[20.0]	9.6	22.7	26.8	

Mr. Salvino. You raise an interesting point of expanding or building new plants. Where would you locate if you have incremental pricing where the process industries or feedstock industries are affected by this much higher price? That does raise the question of Mexico.

Being near Texas, in Monterey, they are charging less than 50 cents for industrial gas for a steel plant. So, you have some serious problems going beyond. Many existing plants do not have much choice but expansion. New plants really do have a very significant economic question as to where they locate.

Mr. Sharp. Would you yield?

Mr. Loeffler. I yield.

Mr. Sharp. It would be difficult to determine actual loss of employment on the basis of change in the phase II rule, it is so hard to calculate any of these things. It strikes me that the comparison with Mexico is totally out of line. Isn't that a regulated price in Mexico? Don't they try to keep the price down there for their industry, precisely to attract industry?

I realize if we push our industrial priced gas higher that makes a differential. That has an impact. They have all that gas down there and they are bound and determined to attract anybody they can. If we had followed your line of thinking we would have a much higher natural gas price today.

I accept the argument that the gentleman from Michigan and others make about what it does in the marketplace in terms of differentials, what it does versus Texas and Indiana, but I have trouble with the very people who advocated and told us "Sock it to us on high prices, we can take that, but just deregulate," that now come in and say "Oh, my goodness, do you realize the U.S. Congress is the one that is going to cause higher prices?"

I understand the way rule 2 was originally written, one can make a much greater case for a much higher price really coming down that you might not have gotten with deregulation. But I have trouble buying the argument that the price under rule 2 is actually going to be higher as it is now written, or about to be written, than under deregulation.

That does not necessarily mean we were right. I am saying do not come tell us that the U.S. Congress is responsible for high prices of natural gas for industry when industry, at least the representatives here today, came and told us "That is fine, give it to us."

Mr. Loeffler. As the gentleman will recall that was several years ago. Had we been able to move toward complete deregulation in 1975, when I had the opportunity of meeting the gentleman, perhaps we would not have had any critical shortages.

Mr. Stockman. I ask the gentleman be given 2 additional minutes.

Mr. Dingell. You have heard the unanimous consent request. Frankly, the Chair is going to object. The time of the gentleman has expired. As a matter of fact the Chair will advise the gentleman that the gentleman from Texas and other members of the subcommittee have consumed more than 5 minutes each.

The Chair is going to recognize our colleague, Mr. Preyer, who is a member of the full committee and is sitting with us today.

Mr. Preyer. Thank you, Mr. Chairman. I want to thank you for your courtesy in letting me join your subcommittee and sit with you today. I found the testimony very persuasive. I will try to return your courtesy by just asking one question.

We have heard throughout your testimony and in your written statements about the possibility of fuel switching, switching from natural gas to oil, by industry. That would contravene our national policy on energy conservation, as you pointed out, and would run the risk of putting a heavier load on residential users.

It was certainly not Congress intent when we passed the Natural Gas Policy Act to have incremental pricing drive industry off gas. My question is that since title II does provide a ceiling for incremental pricing surcharge which is imposed on nonexempt industrial users, given this ceiling, why is there a risk and why is the risk that an industrial company would switch from natural gas to oil?

I might say in my State of North Carolina, industrial users of natural gas, or 70 percent of them, have alternative capacity installed right now and can switch overnight. My question is, what is the risk of this switching taking place given the pricing?

Mr. Grenier. If I can take a crack at that. Unfortunately no administered program, no matter how well intentioned the people are who operate it, will be able to keep up with a dynamic market. According to Platt's Oilgram, No. 6 oil prices on the gulf coast changed 15 times between January 1 and September 1980. It bounced around four times within 1 month. EIA, no matter how good a job it does, cannot keep up with that sort of thing.

There is another point too. The prices are supposed to be set on a regional basis; they are ethically on a State-by-State basis. EIA has announced it does not have enough data to do the State-by-State. So you have multi-state grouping.

Many of your large industrials do not buy on a local basis. They buy in the international market. They may buy a barge load transshipped from Newfoundland, or God knows where. That is one problem. There is another problem. Some people would rather switch than fight after a certain point even if they have to pay a few cents more. You just cannot run a business when your utility prices and your energy prices just flip-flop month after month.

I can assure you now with the softening of resid prices the oil dealers are coming in with a lot of blandishment. Frankly once you have that stuff, and I think my colleagues can testify to this better than I can, once you have that black, gooey stuff you cannot keep it too long; you can keep it for a while but you do not want to have it sit there. You are going to burn it.

So I think there is a strong probability that there will be fuel switching. Instead there have been quite a few documented cases of fuel switching. Let me mention one example. A small distributor located in Minnesota has been severely hurt because its largest industrial customer, who happens to be a member of PGC, had to tell them it was going to switch to No. 6 fuel oil because it could get No. 6 fuel oil $1 below the EIA posted price. That is the danger.

Mr. Preyer. Thank you, Mr. Chairman.

Mr. Dingell. Your time has not expired.

Mr. **Preyer**. So I will make one more comment and perhaps someone will want to comment further on it. Mr. Sharp's argument is that if we had decontrolled natural gas totally rather than phasing it in, the prices to industry right now would be higher perhaps than they are under incremental pricing and, therefore, we would be in as poor a position with foreign competition or a worse position, and that is not Congress fault that we would be in that position.

The only point I would make on that is that in my State of North Carolina it is not so much the fact that the price to industrial users is higher but the objection is that it is higher for some and not for others. It is higher for those under incremental pricing on interstate gas, but it is not higher for those on intrastate gas. As far as domestic competition goes, this is discriminatory. That does not answer your question about the foreign competition.

Mr. **Sharp**. If the gentleman will yield, I accept the gentleman's argument. That I think is one of the central criticisms that can be leveled against this as well as the administrative problem of identifying what those prices are in any timely way for industry.

I just do not accept the macroargument of what we are doing to the entire economy because I think the result, and it is a debater's point at this point based on history of the policy issue, and it is not one I use to defend because I do not, obviously, fully defend the action that we are seeing as the result of rule 2, but I do not debate it any more.

Mr. **Dingell**. The time of the gentleman has expired.

The Chair is going to recognize the gentleman from Ohio, Mr. Brown.

Mr. **Brown**. Thank you, Mr. Chairman.

Gentlemen, I do not know that we need to go back over the same arguments that we had 3 years ago. I guess all of that is now water over the dam or gas out of the vent or something. The question of incremental pricing is the issue at the moment, I guess, since it is now the law.

The process it seems to me is going to be that the Federal Energy Regulatory Commission will come up with its rule 2 sometime in May and then the Congress will have a period of time in which to consider that and act on it. Is it your objective to see this legislation passed prior to that time or to see the rule promulgated and then have the Congress act on that rule and the legislation considered after that or is it your thought that the mere consideration of the issue will set the pattern for how we act on the rule?

Mr. **Gooch**. If I may start on that, Mr. Brown, we understood the purpose of the hearing today was to focus on the question of rule 2 and what the appropriate congressional response to rule 2 is. That is what we are here to talk about. We are here to urge that there be a disapproval in this House of that rule.

Now, whenever you gentlemen are disposed to discuss anything beyond that, we certainly would like to talk about that too. But the immediate issue is the rule 2 and we would urge that that rule be disapproved.

Mr. **Brown**. Mr. Gooch, you are one of those rare people who has not only the enthusiasm of the chairman but my enthusiasm. We occasionally share some of those feelings. Rarely it reflects itself in our approach to legislation but when it does, then everybody is in trouble.

Having been in this business for a while, if we disapprove rule 2, what is your impression of the next thing that happens after that?

Mr. GOOCH. Sir, I do not want to tamper with the gods. I do not know what is going to happen.

Mr. BROWN. Is it up to the Federal Energy Regulatory Commission under the congressional admonition to come up with a new rule 2?

Mr. GOOCH. I misunderstood. They do have a period of time in which they can come up with a new rule, yes.

Mr. BROWN. Do they have an option of any kind in which they just simply throw it back to the Congress and say, "OK, wise guys, what do you do with it now?"

Mr. GOOCH. Frankly, I was hoping that the FERC would do more than simply pose the question to the Congress. In many of the joint comments we urged the FERC to look at the end use and make a considered, reasoned judgment on the application. Without in any way impugning their motives they elected to be a conduit, to design a rule and throw the decision back.

So, I assume under that mode of operation if you disapprove of the rule, they will then have to go back and decide whether to then pose a more substantive, reasoned rule based on the action in rejecting it.

Mr. DINGELL. Would you yield?

Mr. BROWN. Surely.

Mr. DINGELL. If the Chair can make a comment, I think we are in accord that it is permissive that the FERC can come back with a second rule.

Mr. GOOCH. Yes.

Mr. DINGELL. The period of time in which they can come back would be a period of 6 months to 2 years. If they did not, of course then the Congress would have to review what Congress would do. If it went on to disapprove this, FERC is going to have to figure out what they are going to do.

But the power of FERC to take further action is of course discretionary with FERC. Is that correct?

Mr. GOOCH. That is my understanding.

Mr. SHARP. Would you yield?

Mr. BROWN. Yes, with a certain understanding of the generosity of the Chair, I yield to the gentleman from Indiana.

Mr. SHARP. I would think that the debate established at the time of the consideration of the veto might affect FERC's attitude toward that. I think it would probably depend on whether the thrust of that debate was to have a reshaping of the rule or to forget the whole thing.

I have a hunch if we said forget the whole thing that would be the end of it.

Mr. BROWN. The reason I asked the question of Mr. Gooch is because he had the peculiar—I beg your pardon—had the interesting position of having to interpret law for the FERC at one time. That is always a challenge, given the source of the law, and my question to him relates to whether or not the Federal Energy

Regulatory Commission would be in violation if we knocked down their rule 2 and then they did not do anything.

In other words, my next question was going to be, does the law have to be repealed as proposed by Messrs. Preyer and Stockman or can it become like an appendix and just hang up and not do anything until somebody gets in trouble again?

Mr. Gooch. I think you have to distinguish between, in effect, rule 1 and rule 2. I believe I would subscribe to what the chairman said with respect to rule 2. However, if you are going to address rule 1, then it appears to me that you gentlemen have to do that or not as you see fit.

Mr. Brown. So, rule 2 might disappear but rule 1 still is around as the result of the legislation and if you want to undo rule 1 you have to do something on the order of what Mr. Stockman or Mr. Preyer have proposed. I only pose these questions because I am one who feels that the Congress on rare occasions does the wrong thing.

Mr. Dingell. The time of the gentleman has expired.

The Chair recognizes now the gentleman from Washington, Mr. Swift.

Mr. Swift. Mr. Merrels, in another portion of your testimony you were talking about the adverse impact that this would have on industries, particularly those that face foreign competition. I believe what you were saying was that with that price competition from foreign countries that do not have this incremental system, domestic industries would not be able to raise their prices; they would have to swallow it in a variety of ways and some could even, as you said, be pushed over the edge.

I understand the logic behind the statement. Do the kinds of companies that are most likely to be hurt most severely come in an industry as a generic group in which you typically have more foreign competition, or are you talking just simply about those companies in most any endeavor who happen to be marginal anyway, so would be least able to respond to that kind of pressure?

Mr. Merrels. I will start the answer. Perhaps others would like to finish. I think you have both. I think you have those that are in a marginal condition now. They have several choices on what to do. For instance, at a plant in the Midwest you might elect to stay on the interstate market. You might elect to shift your production to the Southwest and go to the intrastate market, if you could.

I suspect that with other industries it would be a matter that they would shift their production from domestically to outside the country and the reference earlier was to Canada or Mexico. Conceivably this could impact the automotive industry.

Others I cannot speak for. We have ourselves, speaking for my own company, for instance, available capacity in Canada to produce insulation. So, I do not think there is a clearcut answer. I think there is a series of all of those things that could happen.

I get particularly concerned if you, let us say, "Well I am going to shift my production from Tennessee to Texas," and you come back and say that is an equal number of jobs, it does not speak too well for those who are not working in Tennessee because they are not going to understand what is going on in Texas.

There are other things that come along with it. There is no easy answer; it is a complicated answer.

Mr. MILLER. Certainly the steel industry is one I am certainly aware has been affected by imports recently. I think incremental pricing will have a drastic effect on the steel industry. You can look at it in two ways, Mr. Swift. if the companies are not able to pass the cost through and still stay within the price-wage guideline at present, which we are doing, then in a very short term there is no change in the amount of imports.

By the same token the cost to operate the companies, the domestic companies, has increased and at the same pricing level you are not able to maintain your income. If you cannot maintain your income you are not able to maintain your plant equipment. So, in the long term certainly the domestic industry becomes less viable and imports would increase.

Mr. SWIFT. I understand that part of the argument. Are there some kinds of domestic industries involved in certain kinds of manufacture that are really more threatened by this than other kinds of domestic industries simply because they have a fiercer kind of foreign competition perhaps for the product they produce?

Mr. MILLER. Someone down there in the particular group might want to answer particularly in respect to the feed stock question.

Mr. GOOCH. Our group does not collect any type of marketing data. So we cannot respond to any type of question along that line.

Mr. GRENIER. I can give some specific information. Two new members of PGC are in the glazed tile business. That industry is beset by foreign competition. It is an energy intensive industry. It is their feeling that if they suffer anywhere near the impact that has been projected it could indeed seriously cripple, if not wipe out, that entire industry.

Now, it is a significant industry in itself. It is not one of the great big industries, but it is a good valid industry and we will just have to import glazed tile.

I can give you another specific example: Coffin Industries which is a steel company, member of ASI in Georgetown, S.C. Their Georgetown ferro reduction facility is an iron-ore reduction operation using feed stock gas. It is in an economically depressed area. There are two employers in the town.

That particular facility takes a full 10 percent of the gas sold by South Carolina Electric & Gas, a very major utility. They are right on the margin and they are beset by foreign competition of course. If that plant has to pay the incremental cost it will probably then be more economical to shut that facility down and provide scrap at a loss of energy consumption overall because that is a very energy deficient type of operation.

Mr. SWIFT. Thank you very much.

Mr. DINGELL. The time of the gentleman has expired.

The Chairman recognizes the gentleman from Indiana.

Mr. SHARP. Thank you, Mr. Chairman.

That raises an important question about the incremental prices, especially phase II. If you are on the transco pipeline, for example, which Mr. Preyer's people are, you are in some sense probably disadvantaged in competition nationally because they are going to have to buy a bigger chunk of newer, more expensive gas than other pipelines because they were one of the most supply short, if I have my facts correct.

Incremental pricing actually accentuates that difference from an industrial point of view because the industrial buyer from that pipeline has to bear a much larger and heavier increase or at least it gets to the cap much faster than perhaps its competitor even on the pipeline in my area which is disadvantaged compared to some others.

This gets to one of the central places where incremental pricing accentuates what our market advantages are anyway, but it makes them greater.

You get to the point that you are talking about that are close—I have a couple in my own district that may be on the border of deciding what on earth they are going to do—then you can kick them over the line in a sense because they will have to decide to go somewhere else or close down.

Mr. Grenier. That is correct.

Mr. Sharp. Mr. Gooch, I know you were not here for rule 1 and you may or may not know the answer, but I have trouble remembering what FERC had to do in setting that cap price. Is it in their power to provide us some stability in rule 1 or are they stuck at automatically having to shift that price?

Mr. Gooch. I would say, sir, they would have to shift the price.

Mr. Sharp. In other words, the law you think locks them into a continuing——

Mr. Gooch. I would say it impels them to do that, yes.

Mr. Sharp. We may have some difference.

Mr. Gooch. I do not mean to be dogmatic about that. I think there are things that could be done but as a general proposition, since they have to interpret and reach these alternate fuel ceilings, it seems to me they are under some compulsion to make those alternate fuel ceilings as current as possible.

Mr. Grenier. The Congress has given FERC very wide discretion on the exemption side, section 206(d). However, I think Mr. Gooch is exactly right, even though you might give some people a partial exemption, you are never going to be able to achieve real equalization because the EIA prices bounce all over the lot. They have a wide range.

FERC does not have the power, they do not see themselves as having the power, to raise the cap price so that you reach equilibrium. Maybe they might consider lowering anybody to the lowest but that would defeat the whole purpose of it and probably would violate the specific provisions of the statute under which you are not supposed to go from No. 1 down to No. 6 unless you find adverse rate impact. It is very difficult to administer.

Mr. Dingell. Would the gentleman yield?

Mr. Sharp. I yield.

Mr. Dingell. I observe that at page 30 of the statute section 204(e) says "determination of alternative fuel cost," then it says "in general, except as provided in paragraph 2, the appropriate alternative fuel cost for any region as determined by the Commission shall be the price per million Btu's for No. 2 fuel oil determined by the Commission to be paid in such region by industrial users of such fuel."

Then it says: "The Commission may, by rule or order, reduce the appropriate alternative fuel cost" if they make a couple of findings to "an amount not lower than the price per million Btu's for No. 6 fuel oil determined by the Commission to be paid in such region by industrial users of such fuel."

Now, they have broad discretion, subject to the findings they have to make, between those two very wide areas.

If the gentleman will yield further, we tried to set up a statute so that you folks in the industrial sector would be able to use a fuel that was the most appropriate and to do so under rules established by FERC that were most appropriate to your region and also to treat you in the fairest fashion we could.

Am I correct that you would have been content if FERC had chosen the price of two rather than six?

Mr. Gooch. No, sir. That was not the question that I was trying to answer.

Mr. Dingell. I am not saying it was.

Mr. Sharp. We are trying to establish the legal question as to what the authority of FERC is and whether or not they could help resolve the bouncing around of those alternative fuel prices.

Mr. Grenier. The statute is something like the Bible. There is a little bit in it for everybody. I do not think you can remove the competitive imbalance through FERC manipulation. If you read this section literally they have to go through hearings and oral comments and all that.

By the time they do all that I think the price will bounce around a bit more.

Mr. Sharp. You can appreciate there is a little bit in it for everybody. We could only pass it in the House of Representatives by one vote. We were lucky to get that one. The vote would not have gone in the direction that the gentleman would generally like.

You may not like the act but the end result would have been less desirable. You may still disagree with that, but I often make that case.

If I could ask very quickly, if we were to resolve the rule 2 problem, that means veto what FERC sends down here, and there was a possibility of FERC providing some administrative stability to the alternative fuel price, assuming they do not jump back to the higher fuel prices if they could, is that a political arrangement you can live with?

Mr. Grenier. Let me start with that one. We feel very strongly on principle, apart from politics, that rates should be based on cost of service and everybody should pay his truly fair share. Therefore, the only solution we see is ultimate repeal.

Now, if rule 2 is vetoed, we still have the 2-year threat of the FERC coming back. If they perceive some change they can come back with another rule 2 which the Congress would have to address again. We think the only solution is to repeal and we would strongly urge that.

Mr. Salvino. That is the chamber's position also. Repeal, and as soon as possible, would save you some trouble in having to have hearings.

Mr. Sharp. You appreciate that while you would like to keep this issue focused on that one little part of this act, that there are plenty of other people shopping around to reopen that act and look at a lot of other questions; everybody from producers to pipelines to consumers, residential consumers, to others.

They would have a field day dealing with a lot of these issues. So, we all would like to do it until we have to get down to making the decision, we can say in principle we would never do x. That also means in principle there are no decisions.

While I am sure you people are men of the world and of the practical world and understand you have to make decisions when many times you do not care for the principle or the end result. However, you do not need a lecture from me.

Mr. DINGELL. The time of the gentleman has expired.

The Chair recognizes the gentleman from Illinois, Mr. Corcoran.

Mr. CORCORAN. Thank you, Mr. Chairman.

Mr. Salvino, in the gas distribution company which is a part of your corporation, Peoples Gas Light & Coke Co., can you tell me what the breakdown is of the residential customers compared to industrial users?

Mr. SALVINO. Do you mean in terms of price?

Mr. CORCORAN. In percentage of usage. What percent of your customers are residential customers; what percent of your customers are industrial customers?

Mr. SALVINO. I am guessing, I think it is around 900,000 in terms of residential. I do have a figure somewhere if I can find it.

Mr. CORCORAN. You can supply the precise figure.

[The following information was received for the record:]

SUMMARY OF PGLC's CUSTOMERS

[For 12 months ended February 1980]

	Customers		Usage	
	Number	Percentage	Volume (Bcf)	Percentage
Residential	841,000	94.8	162.1	52.6
Commercial	40,000	4.5	59.7	19.4
Industrial	6,000	0.7	86.3	29.0
Total	887,000	100	308.1	100

Mr. CORCORAN. I would like to know, in view of the fact that the law has been in effect now for a year and a half or better, can you tell us whether or not your company has made any analysis of what will happen to those industrial users at the point when deregulation comes fully into effect under current law?

In other words, are they captive? Will they stay on natural gas? Will they be weaned off natural gas to some alternative fuel? What will happen to them?

Mr. SALVINO. That question cannot be answered alone on the basis of price. One of the problems in comparing with oil, for example, is that many industrials are more comfortable, feeling that oil is a higher priority. In other words, they are not in the same jeopardy they are in taking gas.

In the gas situation incremental pricing causes you to pay the highest price and also puts you in a position of being knocked off first. So there is some comfort in having oil. The fact is that OPEC may have increased the prices but they have not caused the supply to be unavailable.

So, it is a mixed question. I do not know if we can respond to it. It is both an availability and price question.

Mr. CORCORAN. Are you conducting any surveys of your industrial customers to find out just what their plans might be so that you can make your plans for the future over the next 4 or 5 years?

Mr. SALVINO. We do that all the time. I might add in the major cities, Chicago, Detroit, industrial employment has been going down for many years.

Mr. CORCORAN. That is the way this administration is solving the energy conservation problem.

Mr. SALVINO. It is a very serious problem. To the extent that incremental priced gas adds to that problem and causes the price to increase, it is very, very serious. Our people do constantly look at the industrial market. We are losing the industrial market. It is a very serious employment problem for Chicago.

Mr. CORCORAN. I wonder if Mr. Merrels would be interested in commenting on just how flexible your company might be from the standpoint of going to some alternative fuel.

Mr. MERRELS. I will be happy to.

First of all, as I indicated earlier, we can shift part of our load. For the vast majority of our load we are held captive to natural gas. It is the only fuel that will do the job for us in our process.

In our planning we attempt to look at both price and supply security. It is particularly harmful to, the hot process type industries. In particular, you run a very major risk if you have even a short shutdown or lack of natural gas. The likelihood of bringing that equipment up is quite small. You go to ground zero, you rebuild the entire furnace or whatever the equipment may be.

So, we have really some flexibility and try to backstop ourselves with fuel oil. We have to have a minimum amount of gas to keep the facilities running. They cannot be turned on and off. The steps we have taken recently for expansion of new plants are in the Southwest part of the United States; we have gone on the intrastate market which we feel affords a greater amount of supply security.

We have seen prices move up and prices move down. We try to keep it balanced with fuel oil. And by the way it is an added cost to have fuel oil on hand, paid for, in storage tanks, sitting there ready to go when you do need it, both the equipment and the inventory. To make long-range predictions is what we are trying to do.

I guess I will have to back up on one comment earlier. We have 77 operations in 26 States. It is extremely difficult in a planning situation as to where we are. We had completed at the end of last week a complete review of the 26 State cap prices, got all the information on the 77 plants and found ourselves back to ground zero on quite a few of those States with the change.

You need to line up the suppliers' long-term fuel oil when it is economically desirable, and there are instances where we feel it is and will be in the future. We are in the process of swinging one plant to No. 6 fuel oil as part of its load. You also sometimes have to commit to a take-or-pay contract from the supplier which will continue over a period of time.

So it is a switching it is a commitment. We would like to be planning 5 years cut. I do not plan 5 months out right now.

Mr. Dingell. The time of the gentleman has expired.

The Chair recognizes the gentleman from Michigan, Mr. Stockman.

Mr. Stockman. I have a couple more questions, but before that, I have another answer for the gentleman from Indiana.

Regarding the point the gentleman was making on the cheap Mexican natural gas and competitive differential disadvantage problem that it is causing, the gentleman has to understand the answer to that goes back to the Schlesinger shuffle.

If the gentleman will remember at this time we were advocating decontrol of natural gas. Mr. Schlesinger said no, the price of gas was $1.85. Once he said that, he had to veto the offer of Mexico to sell us gas. They, in turn, made the decision, "We will use our cheap gas at home for industrial purposes and sell the United States our expensive oil at a price which they cannot control."

Phase I, they have kept their cheap gas at home and we are buying their oil. Phase II, we did get through some kind of modified deregulation schedule. We decided to load that extra cost now in the narrow category of industrial users who happen to be in direct competition with the plants that are now getting that cheap gas in Mexico that we otherwise would have received.

The point I am making is that we are never inconsistent but sometimes it is a very complex and subtle process of reasoning we have to go through in order to arrive at the right conclusion.

Mr. Sharp. The gentleman is always consistent and I appreciate that.

Mr. Stockman. Thank you.

There is another serious question that has not been brought up this morning. There is a movement in some of the State public service commissions to preempt Federal incremental pricing which could be causing some havoc for users and also some unfairness in equity in the system.

I wonder if I could get anybody on the panel to comment on that. Basically as I understand it if the States move before these Federal rules take effect, they can effect, in a sense capture, the gains for their own distribution system customers and thereby preclude those so-called savings that we are providing to the residential sector from being distributed to all the residential users on an interstate system.

Once one State does this, this causes the others to scurry into the action. Are we creating a serious problem that may make some of this null and void? If not that, certainly create far more complexity and confusion than was ever intended when we included this section in the Natural Gas Act?

Mr. Grenier. These are the so-called State zero plans. It has launched a new war between the States, war of incremental pricing. The States have decided, at least some of the States have decided, during phase one that it would be much better from their perspective to match what would be the result under incremental pricing, that they would theoretically save themselves all the administrative hassle of reporting data, et cetera if they just raised their industrial rates up to the high sulfur No. 6 fuel cap.

This has a ripple effect on States that do not do it because then those States have to take the Federal surcharges in a disproportionate amount because the States with their own administration, their own plans, have in effect what they call zeroed out the MSAC, saying we cannot absorb any of the surcharges.

Minnesota is a fascinating case in point. That turned out to be a case divided against itself. The representative of the Minnesota Public Service Commission testified before the FERC that that State was put in the agonizing position of having to have residential customers on 11 of its distribution systems in effect subsidized the residential customers on three distribution systems.

Why did that happen? Only three of the distribution systems had industrial loads subject to phase I. The other 11 did not. Minnesota said "We just had to go along with the State system because the other States on the pipeline adopted their own systems."

So, in effect, and this is what this gentleman testified, there was really a subsidization going on by the 11 to the 3.

Now, there is an even worse prospect during phase II. If the States continue to do this in phase II, what Congress intended to have happen cannot happen. Congress intended that the pot of incremental surcharges would be spread to those users subject to incremental pricing. Quite possibly the users would not have to go all the way up to the cap, wherever the cap is set. Nobody has yet figured out the mechanism for getting below the alternate fuel ceiling price.

If you are going to have a State plan there is no other way to in effect zero the MSAC and exempt themselves from the whole Federal system. They have not been able to come to that intermediate level. If the States are going to persist in the State administration capturing all the benefits for themselves, they are going to have to keep the industrial rates at the fuel cap, thereby imposing more of a burden than Congress really intended.

There does not seem to be anything in the statute to present that. The issue is before the FERC. Frankly we of the three groups have urged the FERC to try to figure out how to do it. We have urged them to require all the recordkeeping and data be preserved. Whether they will do this I do not know.

But it is a major problem that the Congress could not have foreseen when they passed this act.

Mr. STOCKMAN. I appreciate your answer. Would it not be fair to say that when we reached a point where we are zeroing out the MSAC we have digressed so far in the neater world of bureaucratese that it is time to cashier the whole exercise?

Mr. GRENIER. Amen.

Mr. DINGELL. The time of the gentleman has expired.

The Chair is going to recognize counsel for questions.

Mr. BRAUN. Mr. Crittenden, in your testimony you referred to the $1.40 difference between the $2.19 price and the $3.59 price as being attributable to the cost of distribution at the retail level. Can you tell me if that number has remained constant over the last several years or has increased?

Mr. CRITTENDEN. I believe Mr. Gooch should answer that. He has the report here.

Mr. Gooch. Mr. Braun, I only brought the No. 1 with me. I will be pleased to run that back. This shows it on a cumulative basis. On a cumulative basis for that year it would have been $1.83.

Mr. Braun. Can you explain why it is that between the first and third quarters of 1979 the price to residential users increased 98 cents while the price to industrial users increased 28 cents? Can you explain why that would have occurred?

Mr. Gooch. No. I will be happy to look into that and see if I can give you an answer.

Mr. Braun. Does anyone else on the panel wish to comment?

Mr. Grenier. I cannot give you an answer but I think directionally one can guess, assuming those numbers are correct, one can guess why that might have begun to happen. I think Mr. Salvino testified earlier that in Chicago——

Mr. Dingell. If counsel will permit, those are AGA figures. I did not pull them out of the air.

Mr. Grenier. I am sure they are accurate. I just do not know those figures.

Mr. Dingell. I do not defend them. I just tell you where they come from.

Mr. Grenier. Mr. Salvino testified that residentials have contributed on his system nothing to profit and taxes. It may well be that on other systems in the country as rate cases were going forward, maybe some of these imbalances were being righted. I do not know that to be a fact. That is just a possible explanation.

Mr. Salvino. I am sure what you are looking at is in particular quarters. If you are looking at the coldest parts of the winter and comparing it to the spring period, your residential rates per se would be at a lower point, the average rate in the middle of winter, than in the summer period when they are at the bottom end of the higher part of the rate schedule.

If you are comparing year to year it would be easier but quarter to quarter there are seasonal factors that create distortions in rate comparison.

Mr. Braun. Your testimony, Mr. Merrels, states that each consumer class should be responsible for bearing the cost which it imposes upon the utility system. How do we go about measuring the fair share of the cost of the Natural Gas Policy Act to be allocated among and between industrial and residential users?

Mr. Merrels. Our history speaks for itself. The technique is the normal cost of service study that is done which identifies what the costs are connected with each class of service. Generally speaking this has been done at the State level.

Mr. Braun. Would this result in different rates to residential and commercial and industrial customers?

Mr. Merrels. Yes.

Mr. Braun. At the Federal Energy Regulatory Commission on January 29, Mr. Grenier testified as follows:

> The industries that we represent certainly do support and have supported the concept and the actuality of deregulation. They do not at all object to paying whatever price it takes to achieve deregulation and to have the benefits of, hopefully, the added gas supplies that deregulation would bring.
>
> What they do object to is selectively being forced to pay other peoples' gas costs. It is that simple. I think as we get into the discussion if some mechanism were found to have all consumers face the same price signal, we would probably have no objection.

I am concerned here with whether or not your group is suggesting that we go to a one-part rate structure or cost of service rate structure. Can you explain?

Mr. GRENIER. I will be glad to. What we are saying is that everybody should receive the same signal. Now you have increased gas cost at the wellhead. In our view those increased gas costs should be flowed through without any tampering, right through to each user. That is done through the ordinary purchase gas adjustment mechanism. It is only when you get down to talking about allocating fixed cost of the transmission and distribution systems that you find differences.

I am not saying everybody should pay the same at all. We should follow cost of service ratemaking and if you impose more of a cost on the system you ought to bear more of the fixed cost. It is that simple. What I am saying about people seeing the same signal is if we are going to have deregulation, higher increased gas cost, that all consumers should see those gas costs flowing through. That is what is done if you do not tamper with the PGA clauses.

Mr. BRAUN. At what point do industrial consumers begin to see that cost? What is the price today that would equate with that position?

Mr. GRENIER. There is no fixed price. You begin to see the signals the minute the PGA's begin increasing.

Mr. BRAUN. The signals are that the residentials pay 98 cents more and industrials pay 28 cents more.

Mr. GRENIER. I think Mr. Salvino put the finger on the reason that those figures are not representative. Your are comparing a winter period with a nonwinter period and many utilities use declining block rates. And a residential user is paying at the rate at the top block because he is only using it for cooking and hot water heating whereas in the winter he is using it for space heating, there is a distortion.

Mr. DINGELL. He said the first and third quarters.

Mr. GRENIER. That is right.

Mr. DINGELL. The first quarter is winter?

Mr. GRENIER. Is winter.

Mr. DINGELL. The third quarter is a summer quarter. It commences July 1.

Mr. GRENIER. That is right. That is exactly the point. In the third quarter the residences are using the gas only for cooking and maybe a little hot water heating. At the declining rate formula they are paying more per unit for the third quarter than the first quarter.

Mr. DINGELL. It says here residential rates for natural gas have always been higher than industrial rates comparing the first and third quarters in 1979 when the wellhead prices of natural gas were higher because of the Natural Gas Policy Act. Incremental pricing had not yet been put into effect.

The difference between the average rate of industrial and residential customers increased from 57 cents to $1.27. During this period residential rates increased 98 cents while the industrial rates increased 28 cents. At the end of the third quarter of 1979 residential users paid an average of $3.59 per MCF while industrial users paid an average of $2.32.

Now that is a difference of $1.37. The increase in rates for residential users over industrial users had gone up 10 cents more than it had during the similar period that we are referring to. So, the increase at the end of the summer period was still higher for the residential user than it was for the industrial user.

I think maybe just for the purpose of getting the record straight I am going to instruct the staff to put in the figures for all four quarters.

[The information referred to follows:]

AGA GAS PRICES BY SECTOR, 1978 and 1979

Average Gas Prices for the First Quarter 1978

($/MMBtu)

	Residential 1st Qtr 1978	Residential Percent Change*	Commercial 1st Qtr 1978	Commercial Percent Change*	Industrial 1st Qtr 1978	Industrial Percent Change*
US	2.33	+ 8.9	2.19	+ 11.2	1.78	+ 10.5
NE	3.84	+ 0.3	3.53	+ 0.6	2.78	-
MA	2.92	+ 11.0	2.80	+ 10.2	2.43	+ 9.9
ENC	2.22	+ 7.2	2.18	+ 6.3	1.72	+ 7.5
WNC	1.96	+ 10.2	1.81	+ 13.8	1.47	+ 14.8
SA	2.79	+ 14.3	2.51	+ 20.1	1.64	+ 3.1
ESC	2.00	+ 14.9	2.15	+ 21.5	1.36	+ 5.4
WSC	2.24	+ 11.4	1.72	+ 13.2	1.75	+ 11.5
M	2.07	+ 26.3	1.63	+ 17.3	1.48	+ 15.7
P	1.85	+ 2.2	2.16	+ 12.6	2.30	+ 17.6

Average Gas Prices for the First Quarter 1979

($/MMBtu)

	Residential 1st Qtr 1979	Residential Percent Change*	Commercial 1st Qtr 1979	Commercial Percent Change*	Industrial 1st Qtr 1979	Industrial Percent Change*
US	2.61	+ 12.0	2.45	+ 12.4	2.04	+ 14.6
NE	3.92	+ 2.1	3.52	- 0.3	2.65	- 4.7
MA	3.18	+ 8.9	3.04	+ 8.6	2.64	+ 8.6
ENC	2.49	+ 12.2	2.47	+ 13.3	1.94	+ 12.8
WNC	2.29	+ 18.0	2.18	+ 20.4	1.82	+ 23.8
SA	3.16	+ 13.3	2.83	+ 12.7	1.81	+ 13.7
ESC	2.32	+ 16.0	2.46	+ 14.4	1.84	+ 17.9
WSC	2.51	+ 12.1	1.96	+ 14.0	1.99	+ 13.7
M	2.38	+ 15.0	1.91	+ 17.2	1.73	+ 23.6
P	2.21	+ 19.5	2.29	+ 6.0	2.54	+ 15.5

Average Gas Prices for the Second Quarter 1978

($/MMBtu)

	Residential 2nd Qtr 1978	Residential Percent Change*	Commercial 2nd Qtr 1978	Commercial Percent Change*	Industrial 2nd Qtr. 1978	Industrial Percent Change*
US	2.62	+ 6.1	2.27	+ 9.7	1.88	+ 14.6
NE	4.13	- 6.0	3.42	- 1.6	2.49	- 4.8
MA	3.40	+ 4.6	2.94	+ 7.7	2.29	+ 9.0
ENC	2.40	+ 1.3	2.18	+ 4.8	1.90	+ 5.0
WNC	2.42	+ 12.0	1.95	+ 16.8	1.43	+ 15.3
SA	3.38	+ 9.6	2.47	+ 15.4	1.74	+ 18.4
ESC	2.38	+ 8.2	2.06	+ 15.1	1.61	+ 18.4
WSC	2.47	+ 13.8	2.08	+ 14.0	1.94	+ 18.3
M	2.19	+ 14.1	1.90	+ 15.9	1.54	+ 19.4
P	1.99	+ 3.6	2.18	+ 8.5	2.28	+ 20.6

Average Gas Prices for the Second Quarter 1979

($/MMBtu)

	Residential 2nd Qtr 1979	Residential Percent Change*	Commercial 2nd Qtr 1979	Commercial Percent Change*	Industrial 2nd Qtr 1979	Industrial Percent Change*
US	2.95	+ 11.7	2.61	+ 14.0	2.18	+ 16.0
NE	4.24	+ 1.2	4.29	+ 22.9	3.15	+ 24.2
MA	3.73	+ 9.4	3.21	+ 8.8	2.45	+ 8.3
ENC	2.79	+ 12.0	2.50	+ 12.1	2.25	+ 17.4
WNC	2.74	+ 18.1	2.32	+ 22.1	1.82	+ 25.7
SA	3.62	+ 9.7	2.84	+ 13.6	2.05	+ 21.0
ESC	2.86	+ 18.2	2.38	+ 16.1	2.25	+ 44.0
WSC	2.68	+ 9.8	2.39	+ 14.3	2.23	+ 14.6
M	2.59	+ 16.1	2.23	+ 20.0	1.83	+ 26.2
P	2.44	+ 22.6	2.60	+ 16.1	2.23	+ 3.2

Average Gas Prices for the Third Quarter 1978

($/MMBtu)

	Residential 3rd Qtr 1978	Residential Percent Change*	Commercial 3rd Qtr 1978	Commercial Percent Change*	Industrial 3rd Qtr 1978	Industrial Percent Change*
US	3.10	+ 8.4	2.33	+ 10.4	1.92	+ 12.9
NE	5.24	- 0.8	3.27	- 2.4	2.62	+ 5.2
MA	4.50	+ 12.5	3.36	+ 18.0	2.58	+ 20.0
ENC	3.01	+ 8.7	2.39	+ 10.6	2.01	+ 11.0
WNC	2.65	+ 7.3	1.77	+ 11.3	1.39	+ 12.1
SA	3.65	+ 10.6	2.37	+ 7.7	1.87	+ 17.6
ESC	2.92	+ 12.3	2.26	+ 22.2	1.70	+ 11.6
WSC	2.71	+ 8.8	2.14	+ 12.6	1.96	+ 18.1
M	2.37	+ 6.8	1.81	+ 3.4	1.39	+ 3.7
P	2.26	+ 5.1	2.26	+ 6.6	2.31	+ 6.0

Average Gas Prices for the Third Quarter 1979

($/MMBtu)

	Residential 3rd Qtr 1979	Residential Percent Change*	Commercial 3rd Qtr 1979	Commercial Percent Change*	Industrial 3rd Qtr 1979	Industrial Percent Change*
US	3.09	+ 16.9	2.82	+ 20.5	2.32	+ 22.7
NE	6.20	+ 20.4	4.19	+ 22.1	3.36	+ 24.4
MA	4.90	+ 8.8	3.56	+ 13.7	2.69	+ 15.0
ENC	3.44	+ 15.6	2.79	+ 19.2	2.44	+ 23.2
WNC	3.18	+ 16.1	2.37	+ 23.4	1.86	+ 29.4
SA	4.08	+ 6.3	2.80	+ 16.5	2.21	+ 22.8
ESC	3.61	+ 25.3	2.42	+ 10.0	2.30	+ 34.9
WSC	3.13	+ 15.9	2.45	+ 17.2	2.30	+ 20.4
M	3.07	+ 20.9	2.50	+ 29.0	2.01	+ 36.7
P	3.09	+ 29.0	2.84	+ 25.1	2.49	+ 13.7

Average Gas Prices for the Fourth Quarter 1978

($/MMBtu)

	Residential 4th Qtr 1978	Residential Percent Change*	Commercial 4th Qtr 1978	Commercial Percent Change*	Industrial 4th Qtr 1978	Industrial Percent Change*
US	2.63	+ 10.4	2.30	+ 11.2	2.01	+ 16.1
NE	4.13	+ 1.0	3.50	+ 0.9	2.83	- 1.4
MA	3.35	+ 8.8	3.00	+ 9.1	2.49	+ 14.2
ENC	2.56	+ 12.3	2.33	+ 12.0	2.12	+ 14.1
WNC	2.14	+ 12.0	1.89	+ 13.9	1.55	+ 19.2
SA	3.17	+ 14.0	2.52	+ 12.5	1.90	+ 18.8
ESC	2.30	+ 13.3	2.12	+ 14.0	1.79	+ 24.3
WSC	2.33	+ 5.4	2.00	+ 9.4	1.98	+ 15.1
M	2.59	+ 27.0	2.21	+ 22.1	1.71	+ 20.6
P	2.37	+ 9.0	2.44	+ 9.9	2.32	+ 5.9

Average Gas Prices for the Fourth Quarter 1979

($/MMBtu)

	Residential 4th Qtr 1979	Residential Percent Change*	Commercial 4th Qtr 1979	Commercial Percent Change*	Industrial 4th Qtr 1979	Industrial Percent Change*
US	3.23	+ 23.4	2.80	+ 23.9	2.50	+ 26.3
NE	4.80	+ 14.8	4.50	+ 26.7	3.83	+ 33.1
MA	4.17	+ 19.1	3.71	+ 20.0	3.02	+ 27.5
ENC	3.04	+ 26.1	3.00	+ 30.3	2.67	+ 28.5
WNC	2.72	+ 21.4	2.33	+ 27.8	2.25	+ 31.4
SA	3.76	+ 16.5	3.15	+ 24.5	2.39	+ 26.9
ESC	3.08	+ 27.3	2.73	+ 28.8	2.29	+ 33.1
WSC	2.79	+ 15.5	2.43	+ 18.5	2.34	+ 17.9
M	2.79	+ 19.2	2.76	+ 35.6	2.82	+ 35.4
P	2.93	+ 33.8	3.12	+ 25.3	2.81	+ 21.8

*compared with same month in previous year

Mr. **Dingell.** Mr. Grenier, you are not telling me that the difference would have shrunk any during the fourth quarter of that year, are you?

Mr. **Grenier.** What I am telling you is that you have two different things. Industries and residences move in opposite directions. The industrial rate tends to be lower in the summer because the consumption is higher. Just for the same reason in the declining rate formula the summer rate would be higher in the summer than in the winter.

Mr. **Dingell.** We do not have any years to compare, these events come so closely together. I will have the staff put the figures in. You are not going to tell me that during the time of substantial rising gas prices, which these were, that we would have seen any significant difference in the figures in other quarters, are you?

Mr. **Grenier.** What I am going to tell you is that because of the way the PGA systems operate the costs at the wellhead are flowed directly through to all users. During 1979 there was no incremental pricing in place and those costs were just flowing through directly.

Mr. **Dingell.** That is the point I make.

Mr. **Grenier.** That is right. They were flowing through directly. Whatever changes there were in rates are attributable to other factors, not the Natural Gas Policy Act.

Mr. **Dingell.** What you are telling me is that for a fair picture we are not only going to have to deal with a time when incremental pricing was in place but during a period when incremental pricing was not in effect and we have not included in our figures the economic conditions of incremental pricing.

That is what you are saying, by dealing with figures that relate to incremental period rates which were affected by incremental pricing?

Mr. **Grenier.** The figures covered in the paragraph you read could not possibly reflect incremental pricing because it had not been implemented. What I am saying is that no matter what figures you look at you are not going to get a really clear picture of what is going on. It is oversimplified to say that this really reflects residential rate increases. It may or may not. It may simply reflect different periods of the year.

Mr. **Dingell.** I would be willing to carry these figures to any neighborhood of your choosing and to convene a meeting of the residents thereof and simply, without debate, ask them whether they thought they had an increase in prices or not and stand on the judgment that would exist on the basis of a show of hands. I am not sure there is anybody else in the room who has a different viewpoint on this matter of incremental pricing than I who would be willing to make that same comment.

Mr. **Salvino.** Mr. Dingell, it seems to me that in this period of time that your numbers refer to, in Illinois specifically, the only increases in rates that have been passed by the State commission in the last 3 or 4 years have been entirely on industrial and large commercials. There have been no changes whatsoever in the residential rates, but the PGA, as was explained, that flows through. That flows through dollar for dollar.

So, they are paying a higher price for gas. As far as rates go, the shift has been all toward the industrial and away from the residential.

Mr. Grenier. We just finished a rate case in Georgia. The rate increase to industry is always proportionately a bit higher than it is to residential. I think what you really need to get an accurate picture is a survey of each of the State commissions covering all of the distribution companies that are regulated and just tabulate the recent rate cases and rate increases.

I think you will find that a lot of these numbers have absolutely nothing to do with rate increases. These are seasonality differences and also reflect difference of rate designs that are already in place.

Mr. Dingell. I will yield back to counsel to deal with this but let me deal with something else that I find troublesome. The rate now for unregulated deep gas is around $6 Mcf. Is that right?

Mr. Grenier. In some cases.

Mr. Dingell. Some deep gas is running as high as $6. The rates for Canadian gas are $4.47.

Mr. Grenier. At the border.

Mr. Dingell. The rate for Mexican gas, just arrived at, is $4.47. The rates I think for stripper gas, which is essentially deregulated, are running as high in some places as $6. What would be the price if we were to deregulate natural gas? What would be the wellhead price of natural gas if we were to deregulate the price of natural gas? Can anybody speculate?

Mr. Salvino. Ultimately it gets down to what is your alternative?

Mr. Dingell. You mean alternative fuel?

Mr. Salvino. Right. There is a point, and I think you focus on the residential market, what is the highest price that the residential market——

Mr. Dingell. What would it be in dollars? In my case if I have gas in my house, it would be a new furnace, that would be the determining factor. Just what would the wellhead price of natural gas be?

Mr. Salvino. Again, we are running into, as I indicated, in some places for some distribution companies the alternative cheaper than oil is electricity. You have five cities now where the second or the cheaper competitive fuel is electricity.

Mr. Dingell. What would the wellhead price be?

Mr. Salvino. I suspect in the $5 area but I do not know.

Mr. Dingell. Somewhere around $5. I do not think there is any controversy on that.

Mr. Gooch. I would think that is a little high, sir.

Mr. Dingell. A little high?

Mr. Gooch. Yes.

Mr. Dingell. What would you say?

Mr. Gooch. The honest answer is that I do not know.

Mr. Dingell. None of us does but you are experts. I am trying to make the best guess I can.

Mr. Gooch. I do not claim expertise on that. Looking at the contract behavior in anticipation of deregulation for just that limited amount of gas that potentially will come out from under regulation in 1985, just the limited amount, it appears to me that a contract pattern is being set at the No. 6 oil price.

Mr. DINGELL. Is being set at what?

Mr. GOOCH. At the No. 6 oil price.

Mr. DINGELL. A mixture of six and two is the Canadian's claim?

Mr. GOOCH. No, just a subjective limited view. I do not claim to have all the facts. You asked for our opinion. Based on the facts I have available to me I would say if you just totally deregulated everything, that it would be not unreasonable to assume a price in the range of the No. 6 oil price.

Mr. DINGELL. High or low sulfur?

Mr. GOOCH. I am sorry, I am not prepared to say that. I do not recall.

Mr. DINGELL. Because of environmental concerns it would probably be at least the low sulfur.

Mr. GOOCH. I do not have any opinion one way or the other. I hate to bring a third view to the thing but based on what Mr. Sharp said, I do want to say that I think the prices for natural gas in the interstate market under a continuation of the status quo, that is to say no deregulation, no Natural Gas Policy Act, would be higher than either deregulation or the Natural Gas Policy Act.

Mr. DINGELL. The reason I am asking the question is as chairman of the subcommittee, I sit here and I know that if we go to a bill which would eliminate incremental pricing, I know how smart my colleagues are on this subcommittee, I know full well that if we go into the question of incremental pricing we are going to also be going into the question of natural gas pricing generally.

We are going to open up the entire Natural Gas Policy Act. You are going to find the entire question, not only of incremental pricing but of total deregulation lying before the Congress and lying before the subcommittee.

I cannot begin to prophesy to you gentlemen what is going to occur. But I can tell you that you had better think about whether you want total deregulation or you do not want total deregulation. If we open the issue up it is not going to be just whether we are going to have a repeal of the provisions of that statute referring to incremental pricing but it is going to relate to the entire question of total deregulation of natural gas.

That will probably be the question arising on the floor. I anticipate you might find that you are going to have before one body or the other, or maybe both, the question of whether or not we are going to reimpose regulation because there are some who would like that too.

There is a third scenario and that is the prospect lying before me and this subcommittee, that we will just embroil ourselves in such intolerable controversy the subcommittee not only will not be able to deal with questions about which you complain, and I think properly so, but we are not going to be able to deal with any of the other energy questions which are very difficult and which are bothersome. Have you gentlemen thought about that?

Mr. SHARP. I know some of our guests here have spent months and months at a time on this issue and others perhaps have not had that glorious opportunity. I think you hit the key here. If we should take up the Preyer-Stockman bill I do not think there is any question it would reopen every other issue.

I think that sets a pattern which makes it impossible to act in this session on that bill. It may get through the House or it may hit a filibuster in the Senate but getting it through all the various steps I would think is impossible.

If you will remember, the last two Congresses sought to deal with the issue in at least two sessions. One failed to do anything on it and the other we did it in the last few days. What you are really talking about then is, you are talking about setting it up in the next Congress and taking 2 years.

Let us assume from your point of view that we head toward greater regulation, that you are successful on a number of issues you would like to be successful on. We are still talking about delay of 2½ years to get the final decision you would like.

In the meantime what we have, and I think that is quite a concession to indicate you would win on all those things, but then what we have is producers out there saying "Wait a minute. The rules of the game are changing again. Should I or should I not hold off?"

One of the problems is all the time we were considering the natural gas bill we knew we were disrupting distribution plans, production plans, because everybody was waiting to see what the results were going to be. I think we would clearly do this again in terms of the pipeline contracts, in terms of the producers making their decisions, in terms of the users knowing.

I guess what I am saying is that I think people do need to think hard about this because if we open it up and we leave the impression open that certainly some players in the system are going to be better off with whatever the decision is, some worse off, everybody will be calculating his bets on that.

I guess I would urge people to strongly think about whether the wisest thing to do is to accept the way the bill was written, like it or not, and believe me even though I voted for the bill there were plenty of things at the time some of us knew were irrational, no matter which side you were on, but it was the only way to get the decision.

We thought it was better for the country to have a decision than no decision at all.

It strikes me when we have everything up in the air we slow down the production and distribution of gas. Maybe the wise thing is to focus on the question of veto of rule 2. If there is adequate discussion in the record I think it is unlikely that they will come back with whole new grand designs.

I doubt those people down there like this issue any better than you do in terms of spending their time, energy, and effort on it. They are looking for a clue I would guess from the U.S. Congress. We set it up that way.

And then examine the question carefully as to whether or not there are administrative ways to address the problems generated by phase I and accept that it is an imperfect, perhaps unprincipled decision, but in principle it may well be that everyone or at least the total system is better off accepting something less than the perfect decision.

I know some of you gentlemen have batted on this issue. But many of us, and I am one of those, have altered our view substantially on the issue and we were almost battered children out of the process. Neither side loved us at all. That is partly the reason for my frustration this morning.

In the end I see people sitting in the audience who made major compromises too and went back to the people they represent and got beat over the head for accepting this proposal.

I suggest that we will take an awful lot of time, energy, and effort and we may produce something worse, not something better, and we may leave so many decisions up in the air that the country as a whole is not better off.

I would urge you to focus your attention on the openings that are limited, that can make an impact and may be positive from your point of view.

Mr. DINGELL. The Chair thanks the gentleman.

The Chair is going to recognize our good friend from North Carolina, Mr. Preyer, for questions.

Mr. PREYER. Mr. Chairman, I have no further questions. I want to thank you and the subcommittee, and I particularly appreciate the frankness with which you and Mr. Sharp have addressed the problems that are before us. I do not think those of us who are seeking repeal quarrel at all with the original purpose behind incremental pricing.

I am not making the argument that it was wrong ab initio—it was wrong in principle, and so forth. We are making the argument on the grounds that conditions have changed considerably since 1978. Factors have come into it which we were not cognizant of in Congress and, therefore, we should deal with a new case. Nothing is decided finally until it is decided right.

But I know this is a judgment for your subcommittee. I appreciate your allowing me to participate today and appreciate all the testimony from these gentlemen.

Mr. DINGELL. The Chair thanks the gentleman.

The panel has been here a long time. I want to express the appreciation of the Chair to all of you for your assistance to the subcommittee, your patience and help.

Our next panel will be composed of Mr. George H. Lawrence, president of American Gas Association, and Mr. Edward L. Petrini, National Consumer Law Center.

Gentlemen, we are happy to welcome you to the subcommittee table. If you will identify yourselves for purposes of the record, we will be happy to receive your statements.

The Chair is going to recognize first Mr. Lawrence and then Mr. Petrini.

Mr. Lawrence, please identify yourself and your associates for purposes of the record.

Mr. LAWRENCE. I am George Lawrence. On my left is Ed Schroer. On my right is Clifford Davis.

Mr. DINGELL. Mr. Petrini?

Mr. PETRINI. My name is Edward L. Petrini.

Mr. DINGELL. Gentlemen, you may proceed.

STATEMENTS OF GEORGE H. LAWRENCE, PRESIDENT, AMERICAN GAS ASSOCIATION, ACCOMPANIED BY EDMUND SCHROER, CHAIRMAN, INCREMENTAL PRICING TASK FORCE, AND CLIFFORD DAVIS, CHAIRMAN, GAS SUPPLY COMMITTEE; AND EDWARD L. PETRINI, NATIONAL CONSUMER LAW CENTER

Mr. LAWRENCE. I am George H. Lawrence, president of the American Gas Association.

First, I would like to thank the subcommittee for this opportunity to testify on what we consider to be a very crucial national issue. As I indicated, I am accompanied today by chief executive officers of two of our AGA member companies: Mr. Edmund Schroer of Northern Indiana Public Service Co., who has been chairman of our incremental pricing task force since it was formed in November 1978; and Mr. Clifford Davis of People's Energy Corp., who has been chairman of the AGA Gas Supply Committee since 1977.

Since I think our focus on the gas supply outlook is so critical to the overall discussion of incremental pricing, I think this additional expertise can be very helpful.

Following my oral summary of my statement, Mr. Chairman, I think these two gentlemen will be helpful to the subcommittee in responding to your questions.

First, AGA's deep concern with incremental pricing predates the enactment of the Natural Gas Policy Act, NGPA. Indeed, it began when incremental pricing emerged as a Federal Power Commission concept in 1971.

We strongly opposed this application at the Federal level. As representative of a group which has been actively involved with both the regulatory implementation of incremental pricing and the broadly based effort to repeal title II of the NGPA, again I wish to commend the subcommittee for conducting a hearing at this early stage in the process of phase II implementation.

Basically, I intend to make two points: One, title I of the NGPA, the phased deregulation of the Federal pricing of natural gas, is working.

Point No. 2, title II of the NGPA is not.

Based on our initial examination of the FERC's conceptual outline of phase II, it is clear that the Commission has struggled really rather mightily to achieve a reasonable implementation of this statute. I think Chairman Curtis, former counsel to this committee, and particularly Commissioner Hall, who conducted several of the informal conferences on this, are to be commended.

Nevertheless, in our view, the contemplated phase II rule will contain many drawbacks. The contemplated phase II rule will greatly expand the scope of incremental pricing. Under rule 1 we would be affecting, by the FERC's own numbers, about 5,000 to 7,000 customers and about 30 percent of the interstate industrial gas sales.

If this is expanded to phase II, it will be affecting over 50,000 industrial customers and some 80 percent of the interstate industrial gas sales. So all of the administrative problems, all of the complexities we have heard about today, are going to be magnified many fold by the expansion in phase II.

By so greatly expanding the scope under phase II, this would expand the negative economic impacts of incremental pricing—and more on that in a moment.

Actually, some industrial load loss has already occurred as a result of even the high sulfur No. 6 ceiling that is already in effect for phase I users, and that same load loss is contemplated and, indeed, promised. In fact, this load loss is occurring now, and I would like to make available to the members of the subcommittee and the staff, and placed in the record, a tabulation that we just compiled overnight.

This is a modification slightly of one we presented to the FERC only late yesterday at 6 in the afternoon.

I might say that this is a very moving target. I just got a copy today of an additional wire by Cities Service Gas Co. that has been sent to the committee, saying an additional load loss would be something like 600,000 barrels of high sulfur.

Mr. **Dingell.** Without objection, the tabulation will be included in the record. [See p. 147.]

Mr. **Sharp.** Is that a loss of boiler-fuel customers?

Mr. **Lawrence.** It is not all boiler fuel, Mr. Sharp; it is some of each.

Mr. **Dingell.** Let us see this in perspective. You say this is not all boiler-fuel users?

Mr. **Lawrence.** Some of these will be phase II customers.

Mr. **Dingell.** Phase II has not yet gone into effect.

Mr. **Lawrence.** I say this is the anticipated load loss.

One of our problems, Mr. Chairman——

Mr. **Dingell.** This is what you feel will occur. This does not deal with phase I or phase II. What I am trying to do is figure out what the document is, or what it says.

Mr. **Lawrence.** The document will be the load loss that has occurred to date under phase I.

Mr. **Dingell.** You just said it was the load loss you anticipated.

Mr. **Lawrence.** That has occurred under phase I, that we are anticipating by these specific instances that will occur under phase II even with the high sulfur No. 6 ceiling that the Commission has indicated would be.

Mr. **Dingell.** Are you saying that phase II load loss is reflected in the figures you are submitting?

Mr. **Lawrence.** Yes, on page 2.

Mr. **Dingell.** How can phase II be included when it is not yet in place?

Mr. **Lawrence.** These are anticipated load losses that the industrial customers have advised our gas companies that as phase II becomes obligated, as announced by the Commission, they are going to go to No. 6.

Mr. **Dingell.** I have no objection to this going into the record, but I do want to have it identified, as to what, in fact, it is. These are figures that relate to load loss that is anticipated, or load loss that has, in fact, occurred?

Mr. **Lawrence.** The load loss under phase I on page 1 is actually that that has occurred. On page 2 I have been using the term, "anticipated."

Let me change it to the word on the top; it says, "potential."

Mr. **Dingell.** Then page 2 is potential load loss. This is under phase II or phase I?

Mr. **Lawrence.** Under phase II, sir. Again, sir, this is a moving target. We will be attempting to supply this subcommittee staff and members with additional data as they become available. I think it is illustrative of the fact that load loss that we say can occur, in fact can really occur.

I would also note that in addition to the loss that is happening, one of the very significant problems we have is the potential industrial market for foregone. I don't know if the subcommittee has had a chance to focus on the Mellon Institute study, the so-called least cost energy strategy; but it is one that the Department of Energy funded and some private sources under the direction of Roger Somme, former director of WEFA. They concluded if we had used a least cost energy strategy over the past 10 years, then several good things would have happ[illegible] We would have used about 30 percent less oil; we would have used half as much electricity.

Actually, the utilization of gas would have gone up very slightly; but that is an interesting product of two things: In the residential and commercial market, the use would have gone down something like 40 percent through better conservation and through more efficient equipment and appliances.

But in the industrial market, to accomplish this desirable end, the industrial use of the gas would have gone up 68 percent.

We submit that the implementation of incremental pricing, the specter of incremental pricing to many industry users, is a roadblock standing foursquare in the way of accomplishing that goal.

I am advised by my associate, Mr. Chairman, that the least cost study was the one that you undertook to share with your colleagues in the Congress by a "Dear Colleague" letter. I think it has very many interesting ramifications.

Another point is the prospect of regional dislocations because the intrastate market is excluded from the application of incremental pricing.

It is a difficult thing to quantify, but we notice something very significant. The industrialization utilization of intrastate has increased 37 percent, and the interstate market a little over 10 percent. So there is over a 3 to 1 focus on that increase in the intrastate market.

Let me outline some of the specifics in the way of the problems of implementing incremental pricing that we submit will only be aggravated by the expansion under phase II:

Incremental pricing is inflationary because the increased gas cost borne by industry will generally be passed on to consumers in the form of higher prices for manufactured goods. This passthrough of the higher industrial cost will be multiplied as the goods in question flow through the manufacturing processes to the ultimate consumer; therefore, it can be anticipated that a $1 increase in the industrial gas cost will result in more than $1 increase in inflation.

Other inflationary effects of incremental pricing include the least efficient use of the gas transmission and distribution system—this is our million-mile pipeline system that is in place representing an investment of some $65 billion—the passthrough to taxpayers and consumers of substantial administrative expenses, upward pressure on oil prices due to industrial shift from natural gas to oil, the passthrough to consumers of high utility financial cost due to load and revenue instability, and the passthrough to consumers of the cost of new storage and peak shaving facilities which will be required as a result of the loss of interruptible industrial customers.

The net effect of this process is that the gas consumer will tend to lose more in terms of higher product prices than he gains from certain reductions in the residential gas bill. In addition, he may even face a net increase in his utility bill, if he lives in an area where the loss of industrial load has led to a greater allocation of fixed utility cost to residential consumers, or where utility costs have risen significantly as a result of incremental pricing.

This is cited as an example in Mr. Schroer's company and tabulation we presented to you. Also, consumers of oil and electricity, of course, bear a fuller burden of inflation induced by incremental pricing because they receive none of the even partly offsetting benefits.

At a time when reduction in oil imports has become a national objective and when the administration encourages displacement of oil with natural gas in the sector, for example, incremental pricing is creating a strong incentive for industry to shift from gas to oil.

Use of No. 6 may reduce this damage, but a significant shift from gas to oil is unavoidable; indeed, it is already happening.

I would just point out that one member company on this tabulation has informed us of the loss of 12 plants that apparently were served by gas. This is the Northern Natural Gas System. I would add, in Mr. Schroer's area, oil refineries are typical examples of large gas consumers who will shift to oil.

Market studies indicated up to 6,000 barrels of additional oil per day will be used in their service area alone.

Another major problem posed by incremental pricing is the reduced competitiveness of American products relative to products manufactured abroad.

One prominent financial analyst has reported that in 1979 Japanese steel companies produced steel at a cost of $369 per ton, or $13 less than the cost of American production of $382 per ton.

Incremental pricing is estimated to add an additional production cost of at least $6 per ton, substantially adding to the already serious domestic production disadvantage.

Incremental pricing also creates incentives for the regional dislocation of industry.

Other problems associated with it include the enormous administrative burdens which will grow again as we go from 5,000 to 7,000 users under phase II, to something over 50,000 under phase I.

My other main point that I will summarize briefly, and that is, title I of the Natural Gas Policy Act is working.

I think there was a concern of an inevitable gas supply downward trend that led many proponents of incremental pricing to support it. Indeed, the incremental pricing program was legislatively conceived in the NGPA and enacted in the shadow of the winter of 1976–77, which was marked by the most severe natural gas shortage in America's history.

With memories of this winter still fresh, it is perhaps not surprising that Congress established a program which would require some industrial gas users to shift to oil or at least encourage it. Today, however, the gas supply outlook has changed dramatically due in large part to the wellhead price incentives and the NGPA pace of exploration and drilling activity has increased.

Seismic crew activity has reached the highest level of 20 years. The drilling rig count for March 1980 reached the highest level since December 1956. Gas well completions for 1979 had apparently reached the highest level in the Nation's history. All of these indicators are harbingers of increased lower 48 States' gas production during the years to come.

It is noteworthy that gas well completions have increased most markedly in areas which offer the promise of gas supplies. Completions of gas wells in the Rocky Mountain overthrust belt increased by 34 percent during 1979. Offshore gas well completions were up by over 10 percent. So-called deep gas wells below 15,000 feet, again up over 10 percent.

In addition, there has been a renewed interest in the Appalachian basin. The prospects of obtaining stripper well gas ceilings, combined with recent deregulation of Devonian shale, has produced a 20-percent surge in gas well completions.

The gas supply outlook is enhanced by establishment of intrastate market access mechanisms under sections 311 and 312 of the NGPA. In addition, progress is being made toward utilization of the vast potential of supplemental gas supplies.

By the year 1985 these supplemental gas sources—including coal gas, Alaskan gas, geopressured methane, tight sands gas, deep gas—from below 15,000 feet, LNG and pipeline gas from Canada and Mexico—could account for 5.7 trillion cubic feet of the Nation's annual gas supplies.

By 1990 this figure could rise to 8.7 trillion cubic feet, and by the year 2000 as much as 14.8 trillion cubic feet per year could be derived from these sources. Such sources will be price competitive in the free market with other fuel.

In light of these developments, the perception that natural gas is limited beyond present capability should be rejected. Recent developments in the Middle East, coupled with the previously unanticipated rate of increase in oil prices, have underscored the importance of reducing oil imports. In light of these developments, Congress should view with utmost concern the prospect of increased industrial oil use as a result of incremental pricing.

Indeed, I think Congress is to be commended for the caution that they exercised in phase II. They were fairly certain of their intentions with respect to phase I, but on that which is applicable to two-thirds of the industrial gas under consideration here, Congress said, "Commission, take a long look at this in detail and then come back to us. But even then, we are going to review what you do come back with."

I think that was a good provision of the bill.

While AGA has never regarded incremental pricing as an effective market ordering mechanism that would restrain interstate pipeline bidding for new gas supplies, we are aware some Members of Congress do adhere to this view. For this reason, we point out

FERC conclusion: "The record demonstrates that the market ordering purpose of title II is unlikely to be achieved beyond industrial boiler fuel users."

For all of these reasons, Mr. Chairman, Mr. Sharp, Mr. Preyer, AGA urges Congress to veto the phase II regulations when they are issued.

Thank you.

[Testimony resumes on p. 150.]

[Mr. Lawrence's prepared statement and attachment follow:]

TESTIMONY
OF
GEORGE H. LAWRENCE, PRESIDENT
THE AMERICAN GAS ASSOCIATION
BEFORE THE
HOUSE ENERGY AND POWER SUBCOMMITTEE
ON THE
CONTEMPLATED FEDERAL ENERGY REGULATORY COMMISSION RULE FOR IMPLEMENTATION OF PHASE II INCREMENTAL PRICING

April 3, 1980

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I am George H. Lawrence, President of the American Gas Association (A.G.A.). I am accompanied today by the Chief Executive Officers of two of A.G.A.'s member companies. Edmund Schroer of Northern Indiana Public Service Company (NIPSCO) has been Chairman of A.G.A.'s Incremental Pricing Task Force since November 1978. Clifford Davis of Peoples' Energy Corporation has been Chairman of A.G.A.'s Gas Supply Committee since October 1977. These two gentlemen are intimately familiar with the massive problems posed by the implementation of incremental pricing -- and they will be discussing with you some of the difficulties which Phase II incremental pricing would generate.

A.G.A. is a national trade association, composed of 300 natural gas transmission and distribution companies in all 50 States. Collectively, these companies account for almost 85% of the nation's total gas utility sales.

A.G.A.'s deep concern with incremental pricing pre-dates the enactment of the Natural Gas Policy Act (NGPA). Indeed, it began when incremental pricing emerged as a Federal Power Commission concept in 1971. As a representative of a group which has been very actively involved with both the regulatory implementation of incremental pricing and the broadly based effort to repeal Title II of the NGPA, I am pleased to participate in these important Hearings on the contemplated Federal Energy Regulatory Commission (FERC) regulations to implement Phase II incremental pricing.

SUMMARY OF A.G.A. POSITIONS

A.G.A.'s views on Phase II incremental pricing can be briefly summarized as follows:

- A.G.A. commends the Subcommittee for conducting a Hearing at this early stage in the process of Phase II implementation. However, A.G.A. believes that additional Hearings should be held once a final Phase II rule has actually been issued.

- Although A.G.A. recognizes that the FERC has struggled to hold to a minimum the economic damage that will be generated by Phase II incremental pricing, the contemplated Phase II proposal will not eliminate the negative economic impact of an expanded incremental pricing program. Indeed, the FERC plans to extend the scope of incremental pricing to the greatest extent that the statute permits. In addition, the use of a high-sulfur No. 6 alternate fuel cost ceiling, while definitely preferable to adoption of the three-tiered approach, will nevertheless raise industrial gas prices by an average of 23% -- with further increases as the price of all oil continues to skyrocket.

- A.G.A. maintains that any expansion of incremental pricing, under any Phase II proposal, will exacerbate the severity of those problems which are inherently associated with incremental pricing. These problems include the inflationary impact of incremental pricing, the incentives for increased industrial use of oil, the incentives for regional dislocation of industry, the reduced competitiveness of American industry, the enormous administrative burden and the adverse environmental impact. The resolution of all these highly complex issues, together with the very significant issue of residential consumer impact, is better left to the State regulatory Commissions.

- A.G.A. notes that certain assumptions which affected the original Congressional decision on incremental pricing have now been called into serious question. The assumptions include the assumption of gas scarcity, the assumption of relative oil price stability and the theory that incremental pricing would operate as a "market ordering" mechanism. The FERC itself has challenged the latter assumption.

NEED FOR FURTHER HEARINGS

A.G.A. commends the House Energy and Power Subcommittee for taking such an early interest in the forthcoming regulations to implement Phase II incremental pricing. This is a matter of vital concern to the nation: a matter which fully merits Congressional Hearings at this stage of the Phase II regulatory deliberations that are being conducted by the Federal Energy Regulatory Commission (FERC).

Nevertheless, we wish to emphasize that today's Hearings should not be regarded as a substitute for further Hearings once a final Phase II rule has actually been issued by the FERC. We believe that further hearings, at a later date, are a necessity if Congress is to make a fully informed decision on the Phase II regulations.

We take this position for two reasons: First, the FERC has not yet reached the final stage of its deliberations on the Phase II rule. Although the Commission has agreed in principle to a conceptual outline of the Phase II rule, there is no firm guarantee that this outline will not be altered when the final rule is actually issued. In addition, while we are pleased that the FERC has issued a press release[1] and a Discussion Paper[2] on its contemplated actions concerning Phase II, these documents are not an adequate substitute for the opportunity to review the text of the final rule itself. Without an opportunity to review the details of the rule itself, no party is in a position to make a complete assessment of the Phase II regulations.

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[1] March 21, 1980.

[2] March 25, 1980.

Second, we note that only thirteen days have passed since the FERC agreed to a conceptual outline of Phase II on March 20. Frankly, this time frame has not permitted A.G.A. -- and other interested parties -- an adequate opportunity to analyze the impact of differences between the originally proposed rule and the final rule that is presently contemplated. In this regard, the Wharton Econometrics Forecasting Associates (WEFA) -- which has prepared, under contract to A.G.A., a number of important studies on the economic impact of incremental pricing -- is currently in the process of revising its estimates completely in order to take into account the contemplated use of a permanent and uniform high-sulfur No. 6 ceiling for Phase II users, along with other data updates which will reflect certain input modifications recommended by various Administration technicians who have reviewed the Wharton model. We will convey these revised estimates to you as rapidly as possible -- but we believe that the absence of adequate analysis at this time underscores the need for further Hearings.

SHORTCOMINGS OF THE CONTEMPLATED PHASE II RULE

Although the text of the Phase II rule has not yet been issued, and although our analysis of the Commission's conceptual outline is still in progress, we are prepared to offer some observations on the basis of the information which is currently available.

It has been assumed in some quarters that, because the contemplated Phase II rule is less unfavorable than many had anticipated, problems associated with Phase II Incremental Pricing have been resolved. However, in A.G.A.'s view, this is not the case. Even though we believe that the FERC has in many cases taken the most reasonable course of action which (in its view) is permitted by the statute, the statute itself poses so many inherent problems that any Phase II rule would pose serious difficulty for the nation -- because it would expand the scope of a damaging program.

We recognize that the FERC has struggled mightily to hold the problems generated by Phase II incremental pricing to a minimum. We also applaud Chairman Curtis and Commissioner Hall for chairing various Informal Public Conferences on this issue. Nevertheless, we must point out that the contemplated Phase II rule still contains certain drawbacks.

Coverage of Industrial Facilities Under the Contemplated Rule

One serious disadvantage of the contemplated rule has received comparatively little attention but provides cause for considerable concern. I refer to the scope of coverage of industrial facilities under the Phase II regulations that the FERC is considering. If the FERC proceeds as presently planned, Phase II incremental pricing will extend to every industrial gas user that is not specifically exempted by the statute. In other words, the FERC is planning to expand the scope of incremental pricing literally as far as the statute permits.

If, as we and many others believe, incremental pricing is inherently contrary to certain vital national objectives, then expanding the coverage of incremental pricing to the broadest extent possible will only serve to compound the damage that is being done by the incremental pricing program. Under the contemplated Phase II rule, incremental pricing could affect as much as 80% of interstate market use of gas by industry -- compared to approximately 30% of the interstate market use of gas under the presently established Phase I regulations. Our concern is that, by nearly tripling the scope of incremental pricing coverage, the FERC will nearly triple the negative economic impacts of incremental pricing. Indeed, if the number of affected users (rather than the affected volumes of gas) is used as a standard, then the contemplated expansion of incremental pricing is even more striking -- since the FERC has estimated that the number of affected users will rise from the 5,000 - 7,000 range to a number in excess of 50,000.

High-Sulfur No. 6 Alternate Fuel Cost Ceiling

Although A.G.A. clearly believes that the contemplated use of a permanent and uniform high-sulfur No. 6 alternate fuel cost ceiling (for Phase II users) is preferable to the possibility of a three-tiered system or a uniform standard based upon No. 2 fuel oil, the use of a high-sulfur No. 6 standard will still impose unacceptable levels of economic damage upon American industry. In this regard, we note that the FERC has estimated that the average industrial rate under the Phase II proposal would be $3.20 per MMBtu -- compared to an average industrial rate of $2.60 per MMBtu in the absence of incremental pricing. Thus, even the use of a high-sulfur

No. 6 standard results in a substantial increase in industrial gas costs. If the FERC figures are correct, the average industrial user will face a 23% increase in gas prices under Phase II incremental pricing.

While this is clearly preferable to the increase of 100% or more that would face some industrial users under a three-tiered system, the impact of a 23% average price increase should not be taken lightly. In fact, we have already heard some reports of industrial load loss under the high-sulfur No. 6 standard for Phase I incremental pricing, which is already in effect. Iowa Power and Light Company has already lost two plants to high-sulfur No. 6 oil -- while United Cities Gas Pipeline has lost one plant to high-sulfur No. 6 oil. In addition, Northern Natural Gas has been informed of 12 plants that will be shifting away from natural gas.

We are currently conducting a survey of our member companies in an effort to quantify the extent of the actual load loss that has occurred under the high-sulfur No. 6 standard that is imposed as part of Phase I. We will report to you the results of our survey as soon as those results become available. In the meantime, the point we wish to stress is that load loss as a result of a high-sulfur No. 6 standard is not a matter of speculation; such load loss has already occurred under the Phase I program.

We also wish to stress the point that the gap between rolled in natural gas prices and high-sulfur No. 6 fuel oil prices will not necessarily remain stable indefinitely. The price gap could increase if oil prices were to rise in steps as they have done during the past six years. In this regard, we note that the FERC has recorded a sudden and substantial increase in high-sulfur No. 6 fuel oil prices since the enactment of the NGPA. Specifically, the price of high-sulfur No. 6 fuel oil has increased -- during this relatively short time period -- from $1.73 per MMBtu to $3.50 per MMBtu.[3] Indeed, the FERC has added that "the price of No. 6 oil is currently as high as the Congress in 1978 could reasonably have anticipated the price of No. 2 to be"[4].

The FERC has also added that "oil prices have increased dramatically faster than the scheduled increase in natural gas prices under the NGPA"[5]. This observation by the FERC underscores A.G.A.'s deep concern that the 23% average price increase under the currently contemplated Phase II rule could become a much larger increase within a few years after the establishment of a Phase II program.

Various Section 206 (d) Exemptions

Certain Section 206(d) exemptions, which the FERC has recently proposed, may appear to minimize the negative impact of Phase II incremental pricing. However, such relief is largely illusory because: (a) the proposed Section 206(d) exemption for certain small boilers would only affect Phase I industrial gas users; and (b) the proposed Section 206(d) exemption for agricultural gas users would only postpone -- rather than eliminate -- the coverage of agricultural gas users under Phase II. Thus, the existence of these proposed exemptions does not alter the case against Phase II incremental pricing.

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[3] FERC Discussion Paper, *mimeo* at page 11.

[4] Discussion Paper, *mimeo* at page 10.

[5] Discussion Paper, *mimeo* at page 13.

Asserted Benefits of Phase II Rule

We note that the FERC has estimated that the combined effect of Phase I and Phase II implementation of incremental pricing would result in a savings of about $23 per year (elsewhere cited as $25 per year) for the average residential gas user. A.G.A. submits that this estimate is unreasonably optimistic because: 1) it does not take into account the direct and indirect costs of administration by the FERC, EIA, State utility Commissions, gas distribution companies and interstate pipelines; 2) it does not consider the fact that average household use of gas will continue to decline due to conservation and efficient new gas appliances; 3) it does not consider the fact that the loss of interruptible industrial customers will lead to increased utility costs for gas storge and peakshaving facilities; and 4) it does not take into account the increased cost of capital for utilities as a result of revenue instability that is induced by incremental pricing. However, even if the FERC estimates are taken at face value, the important question arises of whether the nominal asserted benefits of incremental pricing even begin to justify the enormous administrative expenses and economic disruption which incremental pricing entails.

INHERENT PROBLEMS ASSOCIATED WITH INCREMENTAL PRICING

Once again, A.G.A. wishes to emphasize its view that the concept of incremental pricing is inherently counterproductive and disruptive of the economy. It is true that the amount of damage done by incremental pricing will vary in accordance with the manner in which it is implemented -- and we know that the FERC has made a valiant effort to hold such damage to a minimum. Nevertheless, the FERC has been striving for reasonable implementation of a basically unreasonable statute.

As we have indicated previously in our statement, A.G.A. is currently revising its economic impact projections in order to take into account the policy changes which are reflected in the currently contemplated Phase II rule. Thus, we cannot offer any specific projections of the impact of the contemplated Phase II regulations at this time. Nevertheless, although our efforts to quantify the negative impacts of the current proposal are still in progress, we can point to certain inherent problems posed by incremental pricing which will be exacerbated by any expansion of incremental pricing coverage under Phase II.

Inflationary Impact

Background

Government regulation is widely recognized as one of the principal contributing factors to inflation. Excessive government regulation has stifled U.S. economic growth and productivity, costing industry billions of dollars and thereby putting American produced goods at a competitive disadvantage with foreign products. The Phase II incremental pricing provisions of the Natural Gas Policy Act of 1978 (NGPA), if implemented, would retard U.S. productivity growth, thereby undermining the competitiveness of American industry.

A recent study conducted by the Carnegie-Mellon Energy Productivity Center concluded that if the U.S. had followed a "least cost energy strategy", it would now be consuming 24% less energy. The only major increase in fuel use in that study was a 68% increase of gas use by industry. The Carnegie-Mellon study therefore tied gas use in industry to an overall national strategy for efficient use of all energy forms. Incremental pricing of gas to industry would discourage gas use in industry -- in favor of other, less efficient fuels. This would undoubtedly have an inflationary effect.

The WEFA study that we referenced earlier concluded that Phase I and Phase II incremental pricing would be inflationary to a significant extent. (This study was based upon the Commission's originally proposed rule in Docket No. RM80-10.) The Council on Wage and Price Stability (COWPS) informed A.G.A. that COWPS could not accept the WEFA study conclusions due to certain study assumptions and specifications with which COWPS could not agree.

In response to points raised by COWPS officials and other Administration economists, WEFA is now rerunning its macroeconomic model. According to initial indications, the conclusions reached in the original WEFA study are being sustained in this new series of model runs: that is, the revised findings still indicate that incremental pricing will cause inflation, GNP loss and substantial unemployment. However, as of this writing, these runs are not yet available.

The WEFA model is also being revised in order to permit an assessment of the use of a high-sulfur No. 6 alternate fuel cost ceiling, rather than a three-tiered system, for Phase II users. However, WEFA is still in the process of conducting this analysis -- and no results are available at this time.

Direct Inflationary Impacts

If implemented, the incremental pricing provisions of the NGPA will prove to be inflationary for several reasons:

1) Incremental pricing will artifically price natural gas to industry at parity with imported oil. The cost increases to industry for gas will be passed on in the price of manufactured goods. Historical evidence has shown that these cost increases are multiplied as the goods flow-up through the manufacturing process and eventually reach consumers. Therefore, it can be anticipated that a $1 increase in gas costs to industry will result in more than a $1 increase in inflation.

2) Incremental pricing will cause American produced goods to become less competitive in the international markets. For example, NGPA incremental pricing will cause domestic steel production to become significantly less competitive with imports. Productivity declines in this key industry, or similar manufacturing industries, will be inflationary.

3) Incremental pricing will cause loss of industrial gas sales from interstate transmission and distribution companies. This load loss will result in a less efficient, and therefore more costly, use of our domestic natural gas pipeline system.

4) Incremental pricing will require a significant expenditure of resources -- both financial and personnel -- to administer. These resource expenditures will produce no goods, and will therefore be inflationary.

Indirect Inflationary Impacts

1) Incremental pricing will discourage domestic natural gas use in industry in favor of oil. Increased pressure on world oil markets will result in higher oil prices.

2) Incremental pricing -- even with a high sulfur No. 6 fuel oil ceiling -- will still cause some industry load loss and prevent the recapture of gas customers who previously switched to oil. This revenue and customer load instability poses serious ramifications for gas companies in the financial marketplace. Higher gas utility financial costs (both debt and equity) will eventually be borne by all gas consumers.

3) Over time, the loss of interruptible industrial customers will force gas companies to put in additional storage nd peakshaving facilties. These facilities will raise the price of gas to all consumers.

Residential Gas Price Protection

Given all of the unquantifiable costs associated with incremental pricing -- administrative, financial, technical, etc. -- that are placed upon a gas company, it is unlikely that any real price protection will be realized by residential customers. In fact, many systems will see residential gas prices go up because of incremental pricing.

Reverse Oil Displacement

As members of this Subcommittee are well aware, the reduction of oil imports has become a matter of pressing national concern. As a reflection of this concern, the Administration has made several efforts to promote the displacement of oil by natural gas in the industrial sector of the economy. Incremental pricing, by reducing the attractiveness of natural gas to industrial users and largely eroding the cost differential between the two fuels, is seriously undercutting the national objective of reducing oil consumption.

In a December 1979 survey of our member companies, we learned that our own member company marketing experts anticipate that three-tiered incremental pricing (for both Phase I and Phase II) would result in an 11% reduction of gas volumes sold by utilities in the interstate market. These December 1979 estimates are, of course, in the process of being revised substantially in light of the Commission's recently announced policy changes. Nevertheless, it appears inevitable that some industrial load will shift from natural gas to oil as a result of incremental pricing -- and, as we have noted, we are aware of specific instances in which such loss has already occurred under Phase I. Phase II will surely aggrevate this situation: an impact of Phase II incremental pricing that is surely contrary to the national interest.

Regional Dislocation

Because gas in the intrastate market is not covered by incremental pricing, the prospect of relocation in a gas-producing state will become increasingly attractive if the incremental pricing program remains in effect. At present, it is only boiler fuel industrial fuel users who are exposed to the new incentives for industrial relocation, but Phase II would extend these relocation incentives to other industrial users as well.

It is doubtful that a company, which is otherwise satisfied with its present business location, would relocate on the basis of incremental pricing. However, as members of this Subcommittee are well aware, numerous other factors have already led to a significant relocation of industry from the Frost Belt to the Sun Belt. For those remaining companies who are already seriously considering relocation, the increased gas prices under incremental pricing could well tip the balance in favor of departure from the present location. Essentially, we are contemplating a situation in which gas-producing areas could benefit from industrial relocation while the other non-producing areas would suffer economic disruption.

Other Problems Associated with Incremental Pricing

Certain other problems associated with incremental pricing should also be noted. These problems include reduced competitiveness of American products relative to products manufactured abroad, enormous administrative burdens and an adverse impact on the environment as increased use of fuels other than natural gas leads to higher levels of pollution. Phase II incremental pricing can only make these negative impacts worse -- particularly in the area of administrative problems, since the FERC estimates that the number of affected users will rise from 5-7,000 to more than 50,000.

NEED FOR CONGRESSIONAL REEXAMINATION OF INCREMENTAL PRICING ASSUMPTIONS

A.G.A. wishes to emphasize that, although the FERC has followed what it perceives as its statutory duty by proceeding with the issuance of a Phase II rule, the Commission has not formally endorsed the concept of Phase II incremental pricing.

Instead, the Commission's Discussion Paper makes it clear that the FERC has merely referred to Congress the resolution of important public policy issues posed by Phase II. Congressional approval of Phase II has not been requested; rather, the Commission is seeking a Congressional resolution of issues which the Commission regards as inexplicably intertwined with Phase II incremental pricing.

In particular, the Commission has noted that Congress must decide whether some of the fundamental assumptions which underlie incremental pricing are still valid. For example, Chairman Curtis has said that "It will be up to the Congress to decide whether the Phase II rule we submit for its review adequately meets the social and economic goals of the incremental pricing program or, indeed, whether those goals are still appropriate."[6]

Furthermore, the Discussion Paper summarizes the views of Commissioner Holden as follows: "Commissioner Matthew Holden, Jr. also stressed that incremental pricing reflects social judgments made by Congress. He cited the concern expressed by firms and recorded by the news media that the incremental pricing program will lead to plant closings. 'Such possibilities should be guarded against to the extent of our discretion', Commissioner Holden explained, 'but ultimately, evaluation of the equity involved lies within the discretion of the Congress."[7] In this regard, Commissioner Hall has stated that "the equities are exceedingly complex."[8]

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[6] Discussion Paper, mimeo at page 4.

We urge the Subcommittee to pay close attention to the FERC's call for a sober Congressional appraisal of whether the initial objectives of incremental pricing are truly being served by Title II in general and Phase II in particular. We at A.G.A. submit that, in light of both new information and new circumstances, the assumptions on which Congress based its original endorsement of incremental pricing are subject to the most serious challenge.

Assumption of Gas Supply Instability

Congress passed Title II in November of 1978, but the program emerged from legislation that was conceived in the wake of the winter of 1976-77. As you know, that winter was marked by the most severe national gas shortage in America's history -- and the memories of that shortage no doubt played a pivotal role in the decision to create a pricing program that would invite conversion from natural gas to oil.

However, since the enactment of wellhead pricing incentives and intrastate market access mechanisms in the NGPA, the gas supply situation has been altered to a point at which A.G.A. is fully confident of the gas industry's ability to serve the nation's demand for gas.

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[7] Discussion Paper, mimeo at page 5.

[8] Discussion Paper, mimeo at page 10.

Since enactment of the NGPA, there has been a sharp rise in seismic crew activity. In 1979, the level of seismic crew activity was the highest in twenty years, which is a clear indication of the long range plans for intensified drilling programs in the years ahead.

The weekly rotary rig count reported by Hughes Tool Company, i.e., the number of drilling rigs actually in operation during the week, is generally interpreted as an excellent indicator of future well completions in the United States. The total rig count began to decline late in 1978, the first such declining trend in drilling activity since the second quarter of 1976. Some analysts postulated that this weakness was caused by the NGPA. However, most believed that the dip was caused by a host of factors, including weather conditions, uncertainties associated with oil pricing, temporary imbalances between gas supply and demand and, perhaps to some degree, the incital confusion generateb th the complexity of the NGPA. Now, a year after this decline began, it is clear that the temporary causes of this fluctuation have passed. The rig count in March 1980 reached 2669, the highest level recorded in the U.S. since December 1956.

The effect of the NGPA on gas well completions in the U.S. has also been apparent. Comparison of gas well completions fo 1978 and 1979 shows that gas well compleitons are up 12.6 percent over 1978. In fact, it is now clear that in 1979 the highest level of gas well completions in the nation's historey was achieved.

To analyze the effect of the NPGA on gas drilling, there are four geographic areas which have accounted for almost 90 percent of the drilling increases form 1978 to 1979. Gas well completions in the Overthrust Belt were up 33.9 percent; offshore gas well completions were up 10.2 percent; gas well completions in those areas producing deep gas were up 10.1 percent; finally, the Appalachian Basin gas well completions increased 19.6 percent.

Potential gas supplies in the lower-48 state offshore area are estimated by the Potential Gas Committee to be about 21 percent of the U.S. total. Traditionaly, less than 4 percent of the gas well compleitons have been offshore. This type of imbalance is one of the main reasons that reserve additions are not higher: less new gas has been discovered each year because the drilling is not geographically matched to the potential. The changes in the annual number of offshore gas well completions are important criteria for assessing whether the drilling activity is becoming more optimal. In 1979, completions offshore increased to 293 from 266 in 1978. The well-head price for new gas, which is approximately $2.40 per MMBtu, but will continue to rise under the NGPA, is a major factor in this drilling increase. In fact, when compared to the corresponding 1978 price of $1.52 per MMBtu, the interrelationship between increased incentives and drilling activity is evident. Furthermore, the fact that the NGPA price is a stable and predictable one, not subject to long court review and possible reversal, is an equally important reason for increased exploration and production expenditures.

Another critical region, because of its large resource base, is the lower 48 deep gas at depths of more than 15,000 feet. Approximately 20 percent of our total potential gas is at these depths; yet the annual percentage of deep gas well completions has been less than 5 percent. In 1979 gas well completions in those areas in which most deep gas well drilling occurs increased 10.1 percent over the previous year. This is a dramatic response to the prospect of NGPA deregulation of deep gas (which became a reality in November of 1979).

If there was doubt about the impact of deregulation on drilling activity, the Appalachian Basin provides important evidence. The Appalachian Basin region has been intensively developed since the start of the natural gas industry. Nevertheless, the deregulation of Devonian Shale gas and the establishment of high price ceilings for stripper well gas have initiated an enthusiastic drilling response. A 19.6 percent increase in gas well completions has occurred in this area. Actually, the 4864 gas well completions last year in the Appalachian Basin established another all-time record in this region also.

The other region which is experiencing a major boom in gas well drilling is, of course, the Rocky Mountain Overthrust Belt. Exploration in the Overthrust Belt has both oil and gas objectives. From the gas well completions alone, it can be seen that this is an extremely active area. Gas well completions have increased by 33.9 percent from 744 completions in 1978 to 996 completions in 1979.

The exploration and drilling response to NGPA price incentives -- with its promise of stabilized conventional gas production -- is only part of the story. In addition, the intrastate market access mechanisms in Sections 311 and 312 of the NGPA, when coupled with the FERC's decision to retain the emergency purchases program, have significantly enhanced the ability of the interstate market to tap a pre-existing intrastate gas surplus.

At the same time, progress is being made toward utilization of the vast potential of supplemental gas supplies. By the year 1985, these supplemental gas sources -- including coal gas, Alaskan gas, geopressured methane, tight sands gas, deep gas (from below 15,000 feet), LNG and pipeline gas from Canada and Mexico -- could account for 5.7 trillion cubic feet of the nation's annual gas supplies. By 1990, this figure could rise to 8.7 trillion cubic feet -- and, by the year 2000, as much as 14.8 trillion cubic feet per year could be derived from these sources.

It should be added that the importance of gas energy has recently been stressed in a Carnegie-Mellon Energy Productivity Center study that was mentioned earlier. That study, which was aimed at achieving both energy conservation and a reduction of inflation, called for an increase in the use of only one fuel: natural gas. In that instance, while calling for increased conservation and improved energy efficiency leading to reduced gas demand in the residential and commercial sectors of the economy, the study recommended a 68% increase in the industrial use of natural gas. The Carnegie-Mellon study therefore tied industrial gas use to an overall national strategy for more efficient use of energy in all of its forms. Incremental pricing hinders the pursuit of this important goal.

In light of these developments, the perception that natural gas is a scarce and declining fuel should be soundly rejected. With the rejection of that assumption, much of the theoretical foundation of incremental pricing has been invalidated.

Assumptions Regarding Oil

It is clear that, when the incremental pricing program was conceived and enacted, Congress did not anticipate that the price of oil would rise at such a rapid rate during subsequent years. In addition, the importance of restricting oil imports for reasons of national security had not yet been underscored by subsequent events in the Middle East.

In light of these developments, Congress must re-evaluate incremental pricing in general and Phase II in particular. It is our hope and expectation that Congress will conclude that it is prudent public policy to remove artificial impediments to expanded industrial use of gas. In particular, we urge this Subcommittee to recognize that a shift from industrial gas use to industrial oil use, such as expanded incremental pricing would surely induce, flies in the face of the national interest.

Assumptions Regarding "Market Ordering"

In another area, A.G.A. has always questioned the view that Congress established incremental pricing with the intention of creating a "market ordering" mechanism that would restrain interstate pipeline bidding for gas supplies. A.G.A. has also consistently maintained that such a "market ordering" objective cannot be attained through incremental pricing.

Nevertheless, since the FERC has consistently maintained that "market ordering" was the primary purpose behind the enactment of Phase II incremental pricing, it is important to note the Commission's conclusion that "market ordering" will not actually be achieved through Phase II incremental pricing. In particular, the FERC has specifically stated that "the record demonstrates that the market ordering purpose of Title II is unlikely to be achieved by expanding incremental pricing beyond industrial boiler fuel users."[9]

In light of this finding by the Commission, some of the original Congressional supporters of incremental pricing may find it advisable to reassess thier support -- at least within the context of Phase II.

CONCLUSION

Thank you for this opportunity to testify. My colleagues and I stand ready to answer your questions.

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[9] Discussion Paper, mimeo at pages 13-14.

April 2, 1980 Update
Sample of Reduced Industrial Gas Use Due To Incremental Pricing

Gas Company	Industrial Customers	Load Loss	Comments
	(1) Actual Industrial Load Loss to Date Under Phase I		
Iowa Power and Light Company	Firestone Tire & Rubber Co.	1.2 Bcf/yr	-Both plants have switched to high sulfur No.6 oil.
	Armstrong Tire Co.	0.5 Bcf/yr	
United Cities Gas Company	Goodyear Tire & Rubber Co.	1.0 Bcf/yr	-Switched to No.6 high sulfur oil.
Cities Service Gas Company	Goodyear Tire & Rubber Co.	1.6 Bcf/yr	-Plants have switched to No.6 oil. In addition up to 8.0 Bcf/yr move could be lost if reported alternate fuel prices in the Federal Register continue to be higher than actual selling prices in the market.
	Mid-America Refining Co.	0.1 Bcf/yr	
	Dayco, Inc.	0.5 Bcf/yr	
Northern Natural Gas Company	Minnesota, Mining & Mfg. Co.	0.1 Bcf/yr	-Plants now using: #4 oil
	International Refinery	0.4 Bcf/yr	#6 oil
	Armstrong Rubber Mfg. Co	1.7 Bcf/yr	#6 oil
	Firestone Tire & Rubber Co.	1.7 Bcf/yr	#6 oil-HS
	FMC Corporation	0.3 Bcf/yr	#6 oil
	T.C. Army Ammunition	0.5 Bcf/yr	#6 oil-LS
	Whirlpool Corporation	0.2 Bcf/yr	#6 oil
	Minnesota Mining & Mfg-Urban	1.2 Bcf/yr	#6 oil-LS
	Murphy Corporation	0.4 Bcf/yr	#6 oil
	Maytag Company #1	0.2 Bcf/yr	#6 oil-LS
	Maytag Company #2	0.3 Bcf/yr	#6 oil-LS
	Ford Motor Co.	0.2 Bcf/yr	#6 oil-LS
Northern Illinois	GTE Automatic	0.5 Bcf/yr	-Plants have switched to alternate fuels.
	Caterpillar	1.0 Bcf/yr	
	Stauffer Chemical	1.0 Bcf/yr	
Gas Service Co.	A steel manufacturer	0.8 Bcf/yr	-Plants have switched to No.6 oil in response to actual selling prices below the reported alternate fuel price ceilings.
	A soap manufacturer	0.5 Bcf/yr	

Gas Company	Industrial Customers	Load Loss	Comments
(2) Potential Industrial Load Loss in 1981 Under Phase 2 With a No. 5 High Sulfur Ceiling and 300 Mcf/Day Exemption			
National Fuel Gas Company	A chemical company	1.6 Bcf/yr	-May burn oil in new installations instead of gas because of Phase 2.
	A building materials manufacturer	0.5 Bcf/yr	
Northern Illinois	Nabisco	1.0 Bcf/yr	-May burn oil if reported monthly alternate fuel price ceilings increased significantly.
	Interlake Steel	0.9 Bcf/yr	
	Ford Motor Company	0.2 Bcf/yr	
	Wyman Gordon	1.2 Bcf/yr	
	Forty-Eight Insulation Company	0.1 Bcf/yr	-Small manufacturer who may go to electricity in a new furnace.
Northern Indiana Public Service Co.	Union Carbide	4.0 Bcf/yr	-Oxygen plant may close down.
	U.S. Steel	5.0 Bcf/yr	-Close down of facilities.
Mountain Fuel Supply	U.S. Steel	15.0 Bcf/yr	-Will close down a mill if Phase 2 is implemented (the mill has significant environmental compliance problems as it is).
Peoples Gas Light and Coke Co.	Approximately 60 customers in a wide range of industries	0.1-0.5 Bcf/yr per customer	-Plants that would switch if the alternate fuel price reported in the Federal Register (e.g., April ceiling) continues to be higher than the actual selling price for oil in the market.

Gas Company	Industrial Customers	Load Loss	Comments
Northern Natural Gas Company	Goodyear Tire & Rubber Co.	0.5 Bcf/yr	-May switch to: #6 oil
	Buckbee Mears Realty Co	0.1 Bcf/yr	#6 oil-LS
	Minnesota Mining & Mfg. Co.	0.2 Bcf/yr	#6 oil-HS
	Purex Corporation	0.2 Bcf/yr	#6 oil
	Cleveland Cliffs Iron Co.	1.6 Bcf/yr	#4/5 oil-LS
Public Service Electric & Gas Co.	an oil tank farm	0.7 Bcf/yr	-Will not switch to gas as previously contemplated because of Phase 2.
Philadelphia Electric Co.	U.S. Steel	1.0 Bcf/yr	-May burn oil if reported monthly alternate fuel price ceilings continue to increase.

(3) Potential Increased Cost to Residential Gas Customers

Northern Indiana Public Service Co.	25% of all industrial users will switch-calculated on the three tier alternate fuel price ceiling	42.5 Bcf/yr	-Results in a $75 per year increased cost to residential customers which is equivalent to a 22% increase in the residential bill over current costs of $344/yr or a total $32 million rate increase.
United Cities Gas Company	Goodyear Tire & Rubber	1.0 Bcf/yr	-Will require an increase of 85¢/Mcf, or 35% increase to residential gas customers.
Michigan Consolidated Gas Company	10% of all industrial customers	15.0 Bcf/yr	-Would require an $8 million increase, or $8 annual increase per residential customer.

Mr. Dingell. We recognize now Mr. Petrini.

STATEMENT OF EDWARD L. PETRINI

Mr. Petrini. Thank you, Mr. Chairman and members of the subcommittee.

Thank you for the invitation to appear before your subcommittee. My name is Edward L. Petrini, and I am an attorney for the energy project of the National Consumer Law Center, a Boston-based, federally funded, nonprofit corporation which provides advice and assistance to groups and organizations working as advocates for the poor.

NCLC has participated in incremental pricing rulemaking proceedings before the Federal Energy Regulatory Commission in both phase I and phase II.

While we believe that FERC's proposed phase II rule correctly extends incremental pricing to all industrial users, it is seriously weakened insofar as it fails to protect high priority consumers to the full extent contemplated by Congress.

This failure will permit the imposition of an increasingly harsh burden on those within the protected class who are already reeling under the impact of higher gas prices, particularly the low-income consumers, 60 percent of whom heat their homes with gas.

Specifically, we disagree with FERC's preliminary decisions: One, to establish an alternative fuel price ceiling for phase II nonboiler fuel users at the price of high sulfur No. 6 fuel oil and to extend for another year the present high sulfur No. 6 ceiling for phase I industrial boiler fuel users; two, to permit the temporary establishment by States of rates which would allocate surcharges for phase II industrial customers in excess of $0.75/Mcf to other users, including high priority consumers, within the State; and three, to exempt from incremental pricing surcharges the first 300 Mcf per day of consumption by all phase II facilities.

As to high sulfur No. 6, the Natural Gas Policy Act, NGPA, established the alternative fuel price ceiling for purposes of calculating the incremental pricing surcharges in both phase I and phase II.

Mr. Chairman, you earlier alluded to the statutory language and described how this provision permitted the reduction of the alternative fuel pricing ceiling from the price of distillate or No. 2 oil all the way down to the price of No. 6 oil.

This may be done, however, only if the Commission determines—and these are the standards, the test that the Commission was to apply—this may be done only if the Commission determines that the reduction is necessary to prevent increases in the rates of high priority users which would result from the reallocation of costs due to conversion by the industrial facility or facilities to other fuels.

In other words, the alternate fuel cost must only be lowered from No. 2 for a specific facility or for a category facilities on the same interstate pipeline; and then it can only be lowered to a price not lower than No. 6 oil.

The reduction can only be accomplished upon a Commission determination of the rate impacts on high priority customers of the No. 2 ceilings, specifically the necessity of preventing rate increases resulting from fuels switching by a specific facility or by facilities on the same interstate pipeline.

In evaluating FERC's "Summary of Commission Discussion on Phase II Congressional Submittal," dated March 25, 1980, hereafter "Summary of Discussion," we find no evidence that FERC's preliminary disposition to lower the alternative fuel cost to a price below that of high sulfur No. 6 fuel oil was directed toward a specific facility or to facilities on the same interstate pipeline.

Nor does it appear to be based on a finding concerning the rate impacts on high priority users. In fact, there is no mention at all of these statutory standards in the decision to lower the alternative fuel price ceiling, either in establishing the phase II alternative fuel ceilings or in extending the phase I ceilings for another year after November 1, 1980.

Instead, the Commission notes the argument of commenters that: One, the price of No. 6 is currently as high as Congress in 1978 could reasonably have anticipated the price of No. 2 to be, and that two, the price of No. 2 oil is so high that the economic impact on industry "would be so severe that it could not be absorbed."

Then, without revealing its views on these comments, the Commission observes that "the No. 6 price will accomplish a price shielding result of comparable magnitude to that envisioned by the Congress at the time of NGPA's enactment."

We do not know, and the "Summary of Discussion" does not explain, how the Commission reached this conclusion. Indeed, judging from the Commission's own impact estimates, there seems to be great uncertainty in the Commission's ability to assess the impacts of phase I and phase II. The staff task force attempt, "subject to continuing revision as improved information becomes available," suffers from old end-use data, no differential between interstate and intrastate sources, and the effects of various exemptions.

Even the "Summary of Discussion's" estimated average benefit for high priority consumers, $0.18/Mcf, was apparently the result of a sudden and extraordinary upward revision. Only 5 days earlier, on March 21, the day of the Commission's announcement, the estimated benefit was only $0.15/Mcf.

The Commission goes on to note that serious equitable and distributional difficulties could result if the alternative fuel cost were pegged at No. 2. But the new system of gas pricing by NGPA itself involves serious equitable and distributional difficulties, and the fundamental judgment on those issues was made by Congress.

There is no evidence that Congress intended for FERC to substitute its own notions of proper equitable and distributional impact for the statutory test set forth for reducing the alternative fuel price ceilings in section 204(e).

FERC's concerns for these unspecified equitable and distributional problems may have overlooked the potential equitable and distributional problems already resulting from rising energy prices for high priority consumers, particularly low-income consumers. We will touch upon these problems shortly.

Of course, FERC began with a different approach to the estimate of alternative fuel price ceilings for phase II.

In its notice of proposed rulemaking, it chose the three-tiered approach that had been announced but suspended in phase I in favor of a high sulfur No. 6 ceiling. According to the Commission, it believed that a three-tiered ceiling in phase II would have the same advantages as the Commission had found in phase I: More rate protection for exempt users through maximization of the volume of gas subject to incremental pricing, but minimization of fuel switching.

Nevertheless, the three-tiered ceiling was rejected, apparently because it would have resulted in phase II nonboiler users without No. 6 capability—mostly feedstock and process users—contributing more to the price shielding of high priority consumers than boiler fuel users, who have or who could easily install No. 6 capability.

This may be true, but the Congress lumped all industrial users together for the purposes of incremental pricing. It established a two-level hierarchy of use under title II of NGPA—exempt users and nonexempt users. Apparently the Congress, well aware of the fact that many feedstock and process gas users burn gas for industrial purposes, intended that they should shoulder the burden of incremental pricing along with other industrial users.

FERC does not assess the effects of its decision to lower the fuel price ceiling below the price of high sulfur No. 6 rather than retain the No. 2 standard. Nor does it describe the benefits that were lost to high priority consumers as a result of its decision to abandon the three-tiered approach in phase II.

FERC's willingness to proceed to lower the standards in the face of such admittedly weak data is itself cause for concern, since it requires high priority consumers to assume the risk of uncertainty in a program designed for their express benefit.

Nevertheless, we cannot help noting that DOE's assessment of the relative merits of the single-tiered high sulfur No. 6, No. 2, and the three-tiered approach in accomplishing the asserted statutory and policy objectives of the program—Technical Staff Analysis in Response to Notice of Proposed Rulemaking, February 8, 1980. In its submission, DOE found that the three-tiered approach protected residential and commercial gas customers but that it did not affect the market ordering also suggested as a purpose of incremental pricing. In comparison to the three-tiered ceiling, the resid cap did not do as well in protecting residential and commercial customers. But the high sulfur resid cap was also ineffective in ordering the market; the impacts of the two approaches on market ordering were roughly the same—DOE Staff Analysis, p. IV-VI.

By contrast, the DOE report indicates that a distillate cap could reduce "the most dramatic elements of market instability in 1985," though substantial inefficiency would likely result because lower-value intrastate gas users would remain on the system while the same interstate users switched to other fuels. In terms of rate protection for residential and commercial customers, the distillate cap offered maximum protection both prior to 1985—$0.41/Mcf more than the three-tiered approach in 1985—and after 1985 according to DOE, but it notes that this result may not hold "for particular pipelines where incrementally priced users are currently close to alternative fuels." This seems to be the exact situation addressed by Congress in NGPA section 204(e): The No. 2 alternative fuel price could be lowered in particular cases or for particular categories of users on interstate pipelines when the rate protection for high priority consumers would not hold. In short, the DOE submission does not support selection of the high sulfur No. 6 fuel price ceiling over the three-tiered or No. 2 approaches in terms of the stated goals of incremental pricing.

In fact, the problem cited by FERC as the basis for moving away from the three-tiered approach—the disproportionate burden on nonboiler industrial customers without alternative fuel capability—could have been mitigated by the adoption of a "per Mcf" rather than the proportional method of passing through incremental surcharges. In its report, DOE urged FERC to "reconsider its earlier finding that a proportional passthrough method is superior to a per Mcf passthrough method." However, the "Summary of Discussion" does not address this issue.

Unlike FERC's discussion of the basis for revising nonboiler alternative fuel prices downward, there is no specific explanation of the reasons for having "agreed to recommend to Congress that the three-tiered alternative fuel ceiling approach under phase I would be postponed for another year—until November 1, 1981." This will mean that large boiler fuel users will pay incremental surcharges based on high sulfur No. 6 as the alternative fuel price but there is no express assessment of the impact of this decision on the rates of high priority customers. There is reason to believe that this decision will have no immediate impact on residential and commercial rates on an average, nationwide basis, since the expansion of aggregate maximum surcharge absorption capability—MSAC—for nonboiler-fuel users will probably be sufficient to absorb all incrementally priced gas during the period. But in the absence of more confident data and analysis on specific pipelines, and in light of the fact that the alternative fuel price represents only an upper bound for the surcharge—not the surcharge itself—implementation of the three-tiered approach on the original—November 1, 1980—schedule would have been a more prudent way to accomplish the protective purposes of the incremental pricing provisions of NGPA.

As to the allocation of costs in excess of $0.75 Mcf, FERC's proposal would give States discretion to limit the impact of phase II on industrial customers during the first year by permitting the States to limit any user's surcharge to $0.75/Mcf. If a surcharge exceeds $0.75/Mcf, the State would be able to allocate the excess "to other gas users within the State," according to FERC's "Summary of Discussion." This proposal is offered "in order to ease any serious transitional burden."

Just as in the case of the reduction in alternative fuel price ceilings, there is no assessment of the effects of this proposal on the class intended to be protected. Nevertheless, it is clear that the proposal could have the effect of limiting incremental pricing surcharges to the detriment of high priority users.

In addition, the 75 cents per Mcf rule could result in a ceiling on surcharges that were lower than the price of No. 6 fuel oil.

Leaving aside the substantial issues concerning the consistency of FERC's present ceilings with the statutory No. 6 standard, the potential 75 cents per Mcf limitation could result in an upper boundary on the surcharge being established at a price that was lower than the price of high sulfur No. 6 fuel oil.

We have serious reservations as to whether the FERC has been granted the statutory authority to reduce the alternative fuel price ceiling below the level of No. 6 fuel oil.

By exempting the first 300 Mcf of use by nonboiler fuel customers, the commission has apparently removed a massive amount of gas from being subject to incremental pricing surcharges. While the impact assessment is highly qualified and uncertain, the order of magnitude is staggering—between one-third and one-half of all industrial nonboiler use would be exempted under this provision.

Despite this impact, the "Summary of Discussion" contains no explanation as to why it was necessary.

In its notice of proposed rulemaking, FERC proposed a different approach, an exemption for small industrial facilities covered by phase II.

Specifically, FERC proposed to exempt facilities which used less than 300 Mcf per day in the 6 months prior to the effective date of the phase II regulations. According to FERC's explanation, this new exemption would be consistent with the statutory exemption granted to small boiler fuel facilities. But such consistency is hard to understand.

Just because Congress decided to exempt industrial boiler fuel users whose usage did not exceed 300 Mcf per day during the base period does not mean that Congress likewise meant to exempt nonboiler fuel use which did not exceed 300 Mcf per day. Indeed, if Congress had intended such consistency, why limit the statutory exemption in NPGA section 206(a) to boiler fuel users?

FERC later suggested that its original 300 Mcf per day exemption proposal was justifiable on administrative grounds; there were simply too many small, nonboiler fuel users whose gas consumption would be subject to surcharge under incremental pricing to administer the program effectively.

Under these circumstances, FERC would be well advised to weigh the administrative burden of a broader program against the additional rate burden borne by the class intended to be protected.

Obviously, if the consequences of the exemption are significant, as FERC's early impact assessments suggest, additional administrative resources may be justified. Indeed, FERC might consider reallocating its own resources or seeking additional resources if it finds that administrative costs and difficulties of implementation are simply prohibitive but that simultaneously the benefits to high priority consumers of incrementally pricing one-third to one-half more nonboiler gas would be significant.

The magnitude of the stated burden and the expressed uncertainty on which that magnitude is based argues strongly for a close look at the real administrative costs of this provision, especially where the original administrative justification has been diluted by the application of the exemption to large, nonboiler fuel users who could not have qualified under the original proposal.

All three provisions—the high sulfur No. 6 ceilings, the $0.75/Mcf rule, and the exemption for the first 300 Mcf of use per day—dilute the rate protection of incremental pricing for high priority users. These decisions are not consistent with FERC's own assessment in the notice of proposed rulemaking of the way to achieve the congressional purpose of affording high priority consumers price protection:

> The Commission is highly cognizant of its mandate to afford high priority consumers the full measure of price protection consistent with the purposes of title II, and believes that this protection will be best achieved by maximizing the volume of natural gas use subject to incremental pricing."

But now more than ever it is important to bear in mind this fundamental purpose of incremental pricing; for not only does the price of gas to industrial users remain less than the price of gas to interstate residential users in virtually every instance—$3.70 per Mcf versus an industrial surcharge ceiling of $2.60, as FERC's impact estimate points out—but the differential is increasing.

The American Gas Association's "Monthly Gas Utilities Statistical Report" indicates that industrial gas prices, including gas use by utilities, have risen from an annual average of $1.91/MMBtu in 1978 to a third quarter price in 1979 of $2.32/MMBtu, an increase of 41 cents, or 21 percent. At the same time, however, residential rates have risen from $2.53/MMBtu to $3.59/MMBtu during the third quarter of 1979, an increase of $1.06, or 42 percent. The price differential between residential and industrial customers has doubled on a percentage basis from 1978 through the third quarter of 1979 or, stated another way, the 62 cents differential between industrial and residential rates in 1978 has grown to $1.27, or a 105 percent increase by the third quarter of 1979.

Of course, these figures and the ones offered by FERC represent nationwide averages which mask the real effect of regional and local price differences. For example, while the nationwide average price for residential consumers in 1978 was $2.35, residential consumers in Illinois were paying $3.40; those in Tennessee were paying $1.34, according to "Gas Facts," published by the American Gas Association in 1978.

The combination of sharply increasing gas rates with rising prices for other goods and services has, of course, caused equitable and distributional problems for high priority consumers. But no group has borne a greater burden than the Nation's poor.

DOE's Fuel Oil Marketing Advisory Committee—FOMAC—has been assessing the impacts of rising energy prices on the poor and the resulting need for new assistance programs.

In its final report issued in July 1979, FOMAC recommended a $3.2 billion fuel assistance program based largely on energy prices experienced during 1978. The report described how for 1978, before last year's whopping energy price increases, the average low-income household spent over 18.4 percent of its income on household fuel and utilities.

Of course, this is only an average. Again, there are significant regional differences. For example, the FOMAC report notes one study of low-income energy costs in a midwest city which showed that poverty-level clients were using over 20.5 percent of their incomes on gas heating bills, and oil users were spending 31.8 percent of their income on heating bills.

> Total fuel and utilities bills for gas users represented 25.7 percent of their incomes; for oil users, total fuel and utility bills represented 45.7 percent of monthly income. These low-income families spent 81.9 percent of their monthly income on total shelter—heating, utilities and housing—if they used gas, and 92.9 percent of monthly income if they used oil.

Averages also mask the fact that incomes for many low-income households, especially elderly households, are less than the median poverty income. Consequently, many spent in excess of 18 percent of their income on household energy.

In addition to describing such disproportionate impacts on low-income consumers, the FOMAC report summarizes economic factors which help explain the exceptional inability of low-income people to adjust to rising energy prices; and it shows how "energy, of all goods and services consumed by low-income households, presents a unique threat to the poor's well-being."

First, the poor are in a worse overall position to fight high energy prices than they were before the embargo. Since 1972, according to the report, their average real income has actually declined, despite increases in public assistance.

Second, low-income families are generally incapable of reducing their costs through reducing consumption. "Simply put"—the report states—"the evidence is ample that the poor generally are already conserving as much as they are able—more, in fact, than can be regarded as healthy."

Despite the fact that many would gain from upgrading their homes—their homes tend to be highly energy inefficient—their lack of money prevents them from doing so. Their cash is so tight that it would permit weatherization only by foregoing other necessities.

And, because of the location of their homes, or because of their low credit ratings, access to financing is extremely limited. Moreover, their frequent status as renters means that there is little incentive to invest anyway. This problem is often exacerbated by landlords reluctant to keep their units in good repair or to make improvements.

Finally, unlike the case with most necessity items, the report indicates how substitution in energy is a practical impossibility. According to the report, "In food and clothing, there are many alternative goods which consumers may substitute for a good they can no longer afford—for instance, there has been a dramatic rise in the purchase by consumers of non-name-brand food products in the last 5 years of spiraling prices."

But capital for substitutes among the three main household energy options for poor people—oil, gas and electricity—are so prohibitively high that substitution must take place over a long period of time, with changes in the housing stock itself.

In contrast to FOMAC's projected need for a $3.2 billion program for this winter, the total fuel assistance program amounted to $1.6 billion.

The windfall profits tax has been designed to help during the next 10 years. Under the conference agreement, 25 percent of the first $227 billion in tax revenues is recommended for low-income assistance, plus one-third of any amounts in excess of $227 billion.

The Budget Committee has recommended a $2.2 billion appropriation for 1980-81. But that amount, while already the target of budget cutters, I understand, is likely itself to be inadequate to make up for the increases of the past year and the expected increases in 1980.

Some members of the FOMAC have conducted preliminary estimates projecting a need for 1980 which, depending upon the rate of increase in energy prices, ranges from $4.6 billion to $5.8 billion.

In light of the anticipated shortfall in these assistance programs, and in light of the increasingly harsh burden already being imposed by higher energy prices, including gas, further failures to minimize the impact of energy prices on so many of the Nation's poor simply cannot be permitted.

FERC's suggestion in its summary of discussion, that mechanisms other than incremental pricing might be more successful in transferring assistance to low-income families, offers little solace to people already stretched to the limit.

Title II was designed to help all high priority consumers, including the poor; FERC cannot responsibly dilute that help before it is replaced with something else. For now, incremental pricing is an essential assistance mechanism.

In conclusion, the need for full implementation of the protection contemplated by title II of NGPA has never been greater.

While FERC can be commended for proposing a rule to extend incremental pricing in the face of overwhelming opposition from the natural gas industry and from industrial gas users subject to incremental pricing—many of whom were among the most prominent supporters of deregulation of natural gas prices—FERC should be reconsidering those aspects of its proposals which limit the benefits of this essential program to high priority users.

Thank you.

Mr. DINGELL. Thank you, Mr. Petrini.

The Chair recognizes the gentleman from Indiana, Mr. Sharp.

Mr. SHARP. Thank you, Mr. Chairman.

Mr. Petrini, I can certainly appreciate the import of your testimony, and I guess the difficulty that keeps coming back to me when we have had to sit up here and deal with oil pricing and natural gas pricing and everything else, is that every time we seem to squeeze the balloon on one side in order to hold down the price—we almost always do it in the name of the poor, but in political reality what we end up doing is doing it in the name of the middle class—is that we end up seeing the balloon expand somewhere else.

One of the disturbing things that struck me is that our oil price control system may have actually contributed over the long haul to higher prices on the international market which we then suffered here, and we had the same in a lesser vein problem in the incremental pricing, where, as you indicate, the natural gas pricing fellow on the block that has a home that takes three times as much gas as the person across the city usually gets three times the subsidy out of this, and yet if the testimony is accurate, that we are going to generate increased cost of some products, it is even possible that a poor person could end up paying for some of those increased products, instead of on their gas bill, and their neighbor on the oil which is already way out of sight.

I wonder if you have any comment about this. Your goal is wherever you can get some help, get it, because the system does not seem to provide enough help mechanisms. Every time we keep looking for the equities, we find we have generated a series of problems that we didn't intend and nobody wanted to have happen.

Mr. Petrini. You are right in one sense. I am looking for help wherever I can get it, becauce people are really suffering right now.

But I think there is more to it than that. There is a critical distinction with gas. For one thing, the majority of the poor heat with gas. For another, unlike other goods and services in the economy that can be substituted and simply can be done without, there is no choice for a person who is hooked up to the gas system, no real choice, and particularly no real choice among poor people.

Mr. Sharp. The choice is more expensive?

Mr. Petrini. Exactly. That does not mitigate the harsh impact that is already there. Unlike the case with other goods and services in the economy, the difficulty is that one simply has no choice but to bear that extra cost, whatever it may be.

This program was designed to mitigate those costs. So, what we are suggesting is that it should be strengthened insofar as that was the purpose.

On the other point though, that there will be other people who suffer as a result of paying higher prices for their goods and services, for nonhigh priority gas consumers, if you will, in those other areas of the economy there is more choice.

If we are talking about the allocation of scarce resources, some people can adjust their buying habits accordingly, and in some cases—although I know the industrial customers are not particularly excited about admitting it—some of those costs can, in fact, be absorbed by the industrial user. All of them are not necessarily passed through to the consumers.

Mr. Lawrence. Mr. Sharp, could I comment on that?

Mr. Sharp. Yes.

Mr. Lawrence. We have been very concerned with the impact on them. We have conducted a series of consumer roundtables over this country. As a result, we have been very supportive of the low-income consumer assistance legislation in this Congress and we hope it will be applicable.

Another point that I think that I called to your attention here is that of Commissioner Charles Cicchetti, chairman of the Wisconsin Commission, who has emphasized that the fuel oil consumers have already been clobbered; their prices right now are 70 to 100 percent higher than gas at the burner tip. If by incremental pricing we are forcing greater demand for oil, you are pushing up the price for No. 2 fuel oil to that same consumer and he will get a double whammy.

Mr. Dingell. If that is true, Mr. Lawrence, can you explain to me why it was that within the last 2 weeks I had a delegation of oil jobbers in my office, asking me to push for the price of substitute fuel to be equivalent to No. 2, rather than No. 6?

Mr. Lawrence. No, sir; I can't. It has been my understanding that fuel oil dealers are opposed to incremental pricing as an unwarranted subsidy of residential gas consumers to their competitive detriment.

If a delegation met with you to the contrary, I cannot explain it

Mr. Dingell. Thank you.

I thank the gentleman for yielding.

Mr. SCHROER. I, too, am from Indiana. I would like to make a response regarding the concern for the poor. That is, that I spent a good bit of my time in chambers much less august than these, hearing very legitimate concerns, and shared those concerns.

It does not follow because you have a concern for the poor that the particular rate device proposed is a legitimate device or legitimate way to meet that concern.

I think it is particularly appropriate in the gas industry, where the rates are already at relatively favorable levels, although not adequate for those affected to meet them directly in a forthright fashion, rather than by indirect fashion. My particular company disliked incremental pricing so much conceptually that we were vehemently opposed to passage of the act, even though we wanted deregulation.

One of the reasons for our inconsistency in that is that we have great concern for our residential user and believe only in the kind of mix that we have, where we preserve our industrial loads, can we serve the residential user under favorable terms.

As you gentlemen with your expertise know—an industrial customer of ours is essentially firm, we don't have direct sales in our service territory; we have always litigated against them if they did occur because we always felt the proper way to protect the security of supply and fairness of rate to a residential customer is to have a very high level of industrial market penetration, because then we get an efficient utilization of our distribution system.

Industrial utilization is a 100 percent load factor; residential utilization is about 26 percent load factor. So if the concern is really for the poor, there is not a hostility between the industrial user and the residential user. There is a mutual benefit.

What is good for the industry does not mean that it is bad for the residential user. What is good for one is good for both in the everyday operation of the distribution system. That is particularly true in northern Indiana.

I think that we furnished your office with figures before the passage of the act that if we lost our total industrial load, residential rates would go up in the magnitude of some 40 percent; and we would lose service reliability in that process because if we ever do get another January 17, 1977, the residential user in a system like ours, where some 60 percent is industrial, has no real security of favorable price and security of supply.

So, I don't see an antagonism between the interest of the poor and the interest of the industry with a properly run distribution system, but a mutual assistance.

Mr. SHARP. We found this phenomenon before we looked at the act: If you end up with less gas supply coming through the system, obviously the system has to be paid for, and that cost gets passed on, and at a higher rate for that component. There is a bigger cost because of that.

That was another of those sorts of things that we learned, that we weren't necessarily helping if the supply was not there.

From the testimony heard this morning, we are expecting people to jump off the system, therefore the cost of some systems will have to go up.

I wonder if you people have looked at that?

Mr. PETRINI. We wish that FERC would look at that. That is exactly the test for the reduction of the alternative fuel price ceiling. Of course, there is going to be some switching.

If you are going to raise the price of one commodity, presumably there will be efforts to avoid that price rise. But the question is the extent of that switching, the actual amount of volume involved, as well as the rate impact for that particular system, the amount of the reallocation of fixed cost as a result of the switching.

In addition, I am not sure that I would agree with the implication that merely having larger and larger industrial loads is necessarily in the interest of the rest of the consumers on the system.

Mr. SHARP. Dropping the load off the system may work against the consumer?

Mr. PETRINI. That is one side of it. The flip side is getting more industrial load. I guess one way to look at that is to suggest that as the opportunity for increasing industrial load, the more price sensitive load, increases, there may be a corresponding effort to load more and more fixed costs and the costs of higher priced gas onto less demand elastic customers, that is, those who are already on the system, in this case the residential customers.

DOE points out in its submittal in the phase II rulemaking proceedings before FERC that there is the strong incentive among gas utilities to increase those volumes of industrial use.

Mr. SHARP. Mr. Lawrence, I was happy to see you testified on behalf of the fuel assistance program. I really think it is very important. Many of us have come to agree with the point of view that I think you generally agree with, that we can't run through our pricing mechanism a wellfare program and expect to really deal with the energy problem in this country over the long haul.

We have to separate those two out. What has tended to happen is that among those who have been the most vociferous advocates for the change in the pricing mechanism side of it, when we get into the tough problem of running a program that helps people to weatherize or a fuel assistance program, suddenly their voice is not to be heard or be seen.

I am glad that is not the case in your trade association's group. I hope that you will be successful in getting that message to others. It helps us resolve a very central political problem in this country, and a very honest and sincere problem, and that is, how do we help somebody who is clearly being hurt and will be hurt by the transition that I believe is inevitable and will have to occur in terms of pricing energy in this country.

Yet, the failure to work on both sides of that problem, I think, frustrates our capacity to move. We are moving on the pricing side. I am not sold on all the welfare mechanisms we have to help us; they don't work so well either. But it is a question that it is a lot easier to resolve the pricing issue in this Congress when there is political support for resolving the other part of that problem, and that is, trying to address the very desperate concerns of some people on being able to heat their homes.

I am delighted to hear you testify that your people have recognized that.

Mr. **Lawrence**. To that end, we are engaged in a program—we met just last week with members of the Community Services Administration and the community action groups—in which we are combining some of our gas companies' weatherization program, utilizing the unemployed in the community to actually perform the work, and it is training people to do meritorious work, getting the conservation done.

It is a very exciting prospect that we are interested in pursuing. One of the things we found, too, among our consumer roundtables is that most responsible consumer groups are just that, pretty responsible and pretty hard-nosed; they want to knock out the freeloaders; they want to help people who need the help, period.

Mr. **Sharp**. Also, with the pricing mechanism for welfare, you are really subsidizing all kinds of people who really could do it on their own. The system itself wastes resources in that process, but that choice gets made when there is no alternative, no other way of helping them.

Thank you, Mr. Chairman.

Mr. **Dingell**. The Chair thanks the gentleman.

The Chair recognizes the gentleman from North Carolina, Mr. Preyer.

Mr. **Preyer**. Thank you, Mr. Chairman.

You certainly have been patient today, Mr. Chairman.

I want to say amen to what Mr. Sharp just said; that low-income energy user, residential energy user, certainly needs help.

I would agree that direct help is a much better way to do it than distorting the pricing system, the economic system, to bring aid to them.

They used to say about Justice Murphy, who was a very kindly gentleman but too often let mercy distort some of his legal opinions, that he said about one of his opinions that it was a case of "justice tampered with mercy." I think that is what happens when we try indirectly to help low-income residential energy users, rather than directly.

I wanted to ask Mr. Petrini if he does not feel that we ought to approach this problem through a direct fuel assistance program. FERC told us that incremental pricing provides shelter to all high priority users regardless of their economic need. In other words, what you are doing is subsidizing the wealthy as well as the poor, and in part you are doing it at the expense of low-income users of other fuels, aren't you?

As a consumer advocate, are you not mistaken in this respect?

Mr. **Petrini**. No. Incremental pricing spreads a smaller price increase over a broad number of people. I think that the impact on nongas users who are also poor is likely to be minimal. In fact, to the extent that there is substitution in other products, it is nil.

But by contrast, the burden of failing to implement incremental pricing in its fullest sense is extraordinary. The burden on poor people even for something as small as $23 a year, which is the number that FERC was talking about, $23 per year in their March 25, 1980, submittal, even for that small amount of money that is still significant when you don't have any money.

I should mention in connection with that number that I have some reservations about the way in which it was calculated. I suspect that the benefit will be less than $23 per year under FERC's proposal.

The amount of the benefit is calculated on the basis of full MSAC's rather than on the basis of the actual amount of gas that is incrementally priced. That is to say, the 60 cents per Tcf surcharge is a simple arithmetic calculation of the difference between the average price of high sulfur No. 6 fuel oil and the price of gas. That difference is multiplied by 2.9 Tcf. I don't think that you can necessarily infer that the total maximum surcharge capability will be maximized, at least at the outset.

In fact, the data seem to go exactly in the opposite direction.

Mr. **Preyer**. Thank you.

I think the point we were concerned with is that $23 a year is a relatively modest saving. The question is whether it is worth the risk of higher prices of consumer goods which they would be paying, or whether it is worth the risk of switching so many gas users onto other fuels and therefore loading a heavier price on them.

We are running a pretty big risk for a relatively minor benefit.

Finally, I assume that a number of your consumers and members and clients heat their homes with propane or electricity, rather than natural gas, and I would think that the fact that that group of your consumers under incremental pricing would be subsidizing natural gas users who already have very low pricing, would make it difficult for you to represent that side of the consumer.

Mr. **Petrini**. That was the point I was trying to make, Congressman Preyer, that the impact of raising gas prices on people who have no choice, whether they are middle-class residential consumers who have a limited range of choice indeed compared to industrial customers, or whether it is being applied to low-income consumers, who in many cases have no choice whatsoever, the impact of raising the price of gas on them is much larger than the impact of higher prices on goods and services throughout the economy.

It may or may not be purchased by those low-income electric users and low-income propane users.

Mr. **Preyer**. Thank you.

Mr. **Dingell**. The time of the gentleman has expired.

Mr. Lawrence, I have been intrigued by your submission to the subcommittee here with regard to those who were getting off gas because of incremental pricing. [See p. 147.]

If you will refer to page 1, you look down at the first plant it switched to No. 4 oil. That is Minnesota Mining and Manufacturing Co.; it dropped 0.1 Bcf per year and it switched to No. 4 oil. Now, No. 4 is higher priced than No. 6 high sulfur; is it not?

Mr. **Lawrence**. I presume so, Mr. Chairman, yes, sir.

Mr. **Dingell**. Why would incremental pricing, which is tied to the price of high sulfur No. 6, cause them to switch to No. 4?

Mr. **Lawrence**. I think the reason that I have heard Mr. Ross, our marketing vice president, refer to is that it was the actual availability of oil there. I think in that instance the particular industrial user says we are switching, whether it is No. 6, No. 4, or whatever.

Mr. **Dingell**. What is the cost of No. 4 oil to them?

Mr. **Lawrence**. We will have to provide that for the record.

Mr. **Dingell.** It is higher than the price for No. 6 high sulfur, is it not?

Mr. **Lawrence.** I would presume so.

Mr. **Dingell.** Why would a hardheaded, smart American businessman switch to a higher cost fuel? What would the difference in cost for that amount of oil be?

Mr. **Lawrence.** I think, again, in this instance the particular user said we are going to switch. Now, whether this particular No. 4—Mr. Chairman, there should be a footnote on there explaining that. I think in this case the No. 4 might have been a special price that was even cheaper than what the No. 6 would have been. I can assure you we will provide you the full scope of that transaction.

Mr. **Dingell.** You say, "April 2, 1980, update sample of reduced industrial gas use due to incremental pricing"?

Mr. **Lawrence.** We say, "actual industrial load loss to date under phase I."

Mr. **Dingell.** You say, "incremental pricing."

Mr. **Lawrence.** That is what 3M told Northern Natural. We need to provide you the pricing history involved there.

Mr. **Dingell.** It raises a little skepticism in my mind as to whether maybe there ought to be a stockholder's suit, or perhaps some changes of executive management in that corporation. Does it not strike you that way?

Mr. **Lawrence.** For all I know, before I file a suit, it might even be a typo. We have to provide you some more information on that whole situation. We were putting these together pretty quickly.

Mr. **Dingell.** I assume you read these things before you submitted them to us.

Mr. **Lawrence.** Real quickly.

Mr. **Dingell.** Firestone Tire & Rubber switched to No. 6 high sulfur. Let us go further down. Whirlpool switched to No. 6 low sulfur. No. 6 low sulfur costs more than No. 6 high sulfur?

Mr. **Lawrence.** Normally.

Mr. **Dingell.** Why would they have switched to a higher cost fuel?

Mr. **Lawrence.** Could I let some of my operating men who confront these problems from time to time jump in on this?

Mr. **Schroer.** That is not our operating territory, but it might be that they can't burn high sulfur under environmental requirements.

Mr. **Dingell.** Low sulfur is higher cost than high sulfur. It is also higher priced than gas.

Mr. **Schroer.** I think your earlier comment is probably an accurate one, that is, that most business folks pretty much run their corporation for the benefit of their constituency, and I am sure there are good, sufficient operating reasons why these people did what they did.

Mr. **Dingell.** Why would they switch to low sulfur fuel No. 6 which costs more than gas and which is higher than the spillover price?

Mr. **Schroer.** It may or may not have cost more than gas at the time that transaction was made.

Mr. Dingell. They did not switch off then because of incremental pricing; they switched off because they could get a better deal on low sulfur No. 6; isn't that right?

Mr. Lawrence. Could I just add, these were represented to us as switchings as a result of phase I incremental pricing. What happened is, whatever price was listed here was listed as an oil price that was cheaper than the so-called posted high sulfur No. 6 resid price. It might go back to that horror story Mr. Corcoran referred to, where they posted it at $3.62. The guy buys his oil for $3.15; then they make their correction and it is posted at $2.88.

Mr. Dingell. Are these figures based on the old numbers that came out of the Energy Information Agency or based on numbers——

Mr. Lawrence. They were based on decisions made by these people at the time the EIA postings were in effect.

Mr. Dingell. Which ones?

Mr. Lawrence. All of them. They were represented to us——

Mr. Dingell. Are these based on the correct ones or incorrect ones?

Mr. Lawrence. I don't know. All I know is that they switched; they were represented to us as having been switched.

Mr. Dingell. We are going to have a little session with EIA on this matter of keeping their figures straight. Right now you have given us a large number of folks who were supposed to have shifted from one kind of fuel to another; yet I gather they are shifting to a higher cost one, which is higher than the spillover point.

Mr. Lawrence. No, sir; I think not.

Mr. Dingell. Let us go down to Minnesota Mining & Manufacturing—Urban, 1.2 billion cubic feet a year, switched to No. 6 low sulfur; Maytag No. 1, No. 6 low sulfur; Maytag No. 2, No. 6, low sulfur; Ford Motor, 0.2 billion cubic feet, No. 6, low sulfur.

Why did these folks go to a higher cost fuel instead of staying with gas?

Mr. Lawrence. I think the short answer, Mr. Chairman, is that they didn't. Each one of these industrial users looked at the applicable EIA price level for high sulfur No. 6 and they said, "We can beat it." The fuel oil dealer said, "We can beat it." And they beat it with the type of product shown here.

Mr. Dingell. Let us deal with a number: 300,000 cubic feet per day is 0.1095 billion cubic feet per year; is that right?

Mr. Lawrence. I beg your pardon, sir?

Mr. Dingell. 300 Mcf is 0.1095 billion cubic feet per year; is that right?

Mr. Lawrence. Yes, sir, approximately.

Mr. Dingell. Figures are calculated per year.

Let us go to the next page here: Forty-eight insulation company at page 2 has 0.1 billion cubic feet per year. It says, "Small manufacturer who may go to electricty in a new furnace." Is that because of incremental pricing or is that becuse of environmental concerns, or is that because they have some kind of new process?

Mr. Lawrence. This was represented to us as having been triggered by the EIA price level that they were going to have to present.

Now, what they are switching to as a result of that, in this case there would undoubtedly have to be some other factors involved.

Mr. Dingell. They are entirely exempt, are they not, from the incremental pricing provisions by reason of the 300 Mcf per day exemption? They are entirely exempt from incremental pricing because the first 300 Mcf per day does not count. They are exempt and yet they may switch. Why will they switch if they are exempt? You tell us they are going to be switching because of it, but they are exempt. Can you explain that to me?

Mr. Lawrence. Everyone in this table is above 300 Mcf a day.

Mr. Dingell. They are not. Forty-eight Insulation Co., it says, is 0.1 Bcf per year. That is a little below the break-even point, 0.109, but that first 0.109 is totally exempt from incremental pricing. You are aware of that, I trust?

Mr. Lawrence. You are right on that point, Mr. Chairman. Could I bring my young with a calculator to respond to the question?

Mr. Dingell. Are you aware of that, or not aware of that?

Mr. Lawrence. I am aware of what, sir?

Mr. Dingell. That the first 300 Mcf per day is not subject to incremental pricing?

Mr. Lawrence. Yes, I am aware of that under phase II.

Mr. Dingell. Apparently this fellow is not subject to incremental pricing.

Mr. Lawrence. What this is represented as, Mr. Chairman, is that this is the load loss above the 300 Mcf a day that he is going to incur that switch from. We don't know what his total utilization is.

Mr. Dingell. According to your figures, he is not?

Mr. Lawrence. No. This is the incremental amount that he is going to switch from.

Mr. Dingell. The figure here at the top says, "load loss." Is it load loss or not?

Mr. Lawrence. We are saying in his case he kept his 300 Mcf a day that is exempt on gas and initial 300 Mcf plus a day represented by this one-tenth of a Bcf he has switched. These are representative, being those over and above that which will be exempt.

Mr. Dingell. He is switching to electricity. Are you going to tell me that is not due to some environmental concern and EPA was not breathing down his neck?

Mr. Lawrence. I am sure in that instance there were other factors bearing on that, including security of supply, security of the energy source. What they are saying is, the EIA price triggered his switch. They have lost a load and it is gone.

Mr. Dingell. He was exempt?

Mr. Lawrence. No, he has already used up his exempt part. He did not switch his exempt part. This is in addition to that.

Mr. Dingell. How do you know that?

Mr. Lawrence. That was represented to us, but I am going to be sure I ascertain and get back to you the true facts.

Mr. Dingell. Why isn't that represented to us here?

Mr. Lawrence. By inference it is that.

Mr. Dingell. Will you tell me where it says by inference it is?

Mr. Lawrence. By virtue of the fact that load that is not lost is not included on here.

Mr. Dingell. I can only say I don't think you have done a very good job on this matter.

Let us take a look here at the next one: We have Buckbee Mears Realty Co., at page 3. They are going to be an industrial customer that is shifting off by reason of incremental pricing. Is that by reason of phase I or phase II?

Mr. Lawrence. That is by reason of phase II.

Mr. Dingell. What does a realty company manufacture?

Mr. Lawrence. I could not tell you. It sounds like they have some diversification other than realty.

Mr. Dingell. The load loss is only 0.1 Bcf per year.

Mr. Lawrence. That is the same problem we were in before; that is over and above his exempt amount as represented to us in this tabulation.

Mr. Dingell. They are switching to No. 6 low sulfur?

Mr. Lawrence. Again because the EIA price level he read was higher than the low sulfur No. 6 as represented to us.

Mr. Dingell. Are you telling me that these folks have a boiler that is going back and forth between high and low sulfur, or between residual oil and gas?

Mr. Lawrence. Yes, sir.

Mr. Dingell. Do you know?

Mr. Schroer. I know in our own service territory.

Mr. Dingell. Do you know about this particular one?

Mr. Schroer. I know in northern Indiana it happens with regularity.

Mr. Dingell. If I were to swear you, Mr. Lawrence, would you testify the same way, that these were all matters of personal knowledge on your part, or you are just speculating now?

Mr. Lawrence. I am representing just as we have, Mr. Chairman. As I said, we are putting these things together quickly.

Mr. Dingell. What you are telling me is that you don't know?

Mr. Lawrence. I don't know with great certainty, but we think, based on our knowledge of the industry, and having switched back and forth, we think it is a very reasonable assumption that has been represented to you.

Mr. Dingell. You are saying it is a reasonable assumption?

Mr. Lawrence. Yes. There are several reasonable assumptions. The only way would be to swear in the Buckbee Mears Realty.

Mr. Dingell. "Reasonable assumption" is specious, is it not?

Mr. Lawrence. We polled our people and our gas companies tell us, "This is the load we are losing as a result of incremental pricing and here are the circumstances." What this says to us is, over and above 300 Mcf a day, Buckbee Mears Realty Co. spun off additional load amounting to a tenth of a Bcf because they read an EIA price level of high sulfur No. 6, that fuel oil dealer represented he could present a lower price to him. It turned out to be low sulfur No. 6 that he could operate on. So he did it. That is what the gas company told us.

Mr. Dingell. That is speculation on your part?

Mr. Lawrence. I think our gas companies are honest people.

Mr. Dingell. You have never inquired about these facts of the companies you are dealing with, have you?

Mr. Lawrence. My people who took the poll did.

Mr. Dingell. Did you ever inquire and say, "Why are these various figures here?"

Mr. Lawrence. I don't take these polls, Mr. Chairman. I don't know it, myself. I think our people did make such inquiries to ascertain.

Mr. Dingell. I trust my staff implicitly, too. I must say if my staff were to come to me with this number of assumptions, I probably would be making some staff changes.

Mr. Lawrence. As of this juncture, we have no reason to doubt any of these.

Mr. Dingell. As of this moment, we have no reason to assume that there is any factuality in these things.

I must tell you that I am unware of any realty company that would be covered under the incremental pricing.

Are you aware of any realty company in the manufacturing business?

Mr. Lawrence. I am sure you are having a lot of fun with me and I am enjoying it, too. But, I am sure the Buckbee Realty Co. has some diversification that I am not familiar with.

Mr. Dingell. It is curious when a realty company goes to a higher cost fuel rather than lower cost fuel when the load lost is within the limits of the exemption from incremental pricing, is it not?

Mr. Lawrence. Again, sir, as represented to us the load lost here is over and above the volumes that that realty company is using, that is over and above the exempt 300 Mcf a day.

Mr. Dingell. Was that statement ever made in your hearing?

Mr. Lawrence. When we polled the people—was that statement ever made in any of our hearings—the answer, Mr. Chairman, is, I am assured, yes.

Mr. Dingell. On the basis of your best assumption——

Mr. Lawrence. There is our man who made these polls.

Mr. Dingell. Let's go down to Cleveland Cliffs. They are known as good, hard-headed businessmen. They switched to No. 4 or 5 low-sulfur oil. Can you explain to me how they were compelled to switch to 4 or 5 low-sulfur oil by reason of incremental pricing when low sulfur No. 4 or 5 costs substantially more than high sulfur No. 6?

Mr. Lawrence. Again, based on the EIA presentations of what high sulfur No. 6 would be, the EIA number does not represent what certain fuel oil dealers may be offering industrial users in any particular area. It is one of the inherent problems.

Mr. Dingell. Isn't it possible then that some of these fellows found it expedient to switch to a cheaper fuel because it so happened that they found there was a bunch of distressed residual fuel oil available that they could get very quickly?

Mr. Lawrence. Yes, and that the gas price could not match it because of the rise to the States' set level.

Mr. Dingell. What is the price of resid right now per million Btu? Is it around $3?

Mr. Lawrence. About $2.40.

Mr. **Dingell**. You are saying that is $14.40 a barrel?

Mr. **Lawrence**. Yes. We are advised, looking back over at the load lost on phase 1 in Iowa Power & Light Co., a rather large load—that the No. 6 oil switched to was in the range of $2.40 and the gas price was in the range of $2.80 and the resid was $2.40.

Mr. **Dingell**. The spillover point under the rule, as I understand, is $2.60. That is what industrials pay now, $2.60. I will yield to counsel.

Mr. **Lawrence**. It is based on high sulfur No. 6 and EIA tries to ascertain what that is.

Mr. **Braun**. Isn't it correct that the current average price to industrials is $2.60?

Mr. **Lawrence**. I could introduce Dr. Schlesinger and Dr. Itteilag who conducted this poll for us and let them respond.

Mr. **Dingell**. Ask them to join you at the table.

Mr. **Braun**. If residual fuel oil prices have fallen to the $12 to $15 per million Btu range, aren't you below the average cost to industrials right now, without any incremental pricing at all? Forgetting incremental pricing, your average price is $2.60 to industrials and you are saying now that the cap price of residential fuel is at $2.40.

Mr. **Schlesinger**. According to FDRC posted—EIA's posted March 29 survey applicable for the month of April, the average price of No. 6 oil that is expected in April is $2.95 a million Btu. However, prices substantially less than that are observed in regions all around the country. For example, in Iowa the price of $2.47 has been observed.

Mr. **Dingell**. What about the regions that you alluded to here in the paper? Would they be lower?

Mr. **Schlesinger**. I am sorry. I don't understand.

Mr. **Dingell**. The regions you alluded to in the paper you submitted. Those would be regions where the price would be $2.40.

Mr. **Schlesinger**. In some instances, $2.40 or $2.47, in Iowa. I cannot speak to what it is in the other regions, but clearly the price is below the April price.

Mr. **Dingell**. You have one listed here in Iowa, Iowa Power & Light. There you are in an area where you told us the price was $2.40. So even without incremental pricing, those folks would switch, would they not?

Mr. **Schlesinger**. It is not clear.

Mr. **Dingell**. Wait just a minute. You just told us the price was $2.40. You have two plants here that you say switched and they would have switched without incremental pricing.

Mr. **Schlesinger**. The price of gas, as it would have been to these customers without the EIA postings, is something I cannot answer to.

Mr. **Dingell**. That price would be fixed by the State utility commission, would it not?

Mr. **Lawrence**. Yes.

Mr. **Dingell**. Or would have been fixed by long-term contract regulated by FERC, would it not, so that statement doesn't have any meaning at all here? These people, the first two people you talked about, Iowa Power & Light, Firestone Tire and Rubber, and

Armstrong Tire would have both switched because of the price differential you have been telling us about. Would they not?

Mr. **Schlesinger.** I cannot say.

Mr. **Dingell.** Isn't the answer to that "Yes"?

Mr. **Schlesinger.** I cannot say what the price of natural gas would have been to these users. I am not acquainted with what the price would have been to these users.

Mr. **Dingell.** But, they were not caused to switch by reason of incremental pricing?

Mr. **Schlesinger.** Definitely they were.

Mr. **Dingell.** How can you say so when the price for the oil was well below the price for gas prior to any incremental pricing surcharge?

Mr. **Schlesinger.** I never said that. I don't know where that figure came from.

Mr. **Dingell.** The price of residual fuel oil was $2.40.

Mr. **Itteilag.** Mr. Chairman, in this particular case, it is a valid one, what happened here.

Mr. **Dingell.** You think this is a valid one?

Mr. **Itteilag.** In this case with Iowa Power & Light, the posted price was much higher than the actual selling price for oil in this particular service area. Particularly, oil companies sold it much lower than the market price at $2.40 to the same customers who were seeing the posted price of gas closer to $3. So, they made the switch purely on economics due to implementation of phase I.

Mr. **Dingell.** What was the price before?

Mr. **Itteilag.** Which fuel?

Mr. **Dingell.** Gas?

Mr. **Itteilag.** In that region?

Mr. **Dingell.** Yes.

Mr. **Itteilag.** The price of gas has also been lower in that region than the posted price of EIA.

Mr. **Braun.** The questions is do you know what the price was to the user who switched? Was it above or below $2.40, before you take into account any effect of incremental pricing?

Mr. **Itteilag.** The answer to your question is the fact they saw a lower oil price than the gas price and in that particular state due to the EIA posting?

Mr. **Dingell.** You are complaining then about the EIA posting requirement?

Mr. **Itteilag.** Definitely so.

Mr. **Dingell.** But, you are not complaining about incremental pricing? We are going to have EIA up here, but this is not incremental pricing. This is just a bad EIA posting.

Mr. **Itteilag.** In order to implement incremental pricing, you need a posted price. The way this posted price is made, it is done on a very insignificant sample. It is not based on a statistically valid sample and it is not validated in any way, shape or form.

Mr. **Dingell.** What was the price of gas——

Mr. **Lawrence.** That is what we are going to introduce in the record. We think the industrial price of gas was $1.85. The EIA original posted price was $3.01 which would be a substantial jump. They corrected it from $3.01 to $2.73.

In the meantime, the guy looked at the posted price and said, "I can buy oil somewhere between $1.85 and the $3.01," that is, $2.73, after he did it.

Mr. Braun. You said the lowest price was $2.47.

Mr. Lawrence. If I said that, it was in error. What we are telling you now is based on what we think we see in it.

Mr. Schlesinger. Mr. Lawrence just indicated on the record, which we will repeat, that the most recent price to industry in that region we are acquainted with is published in EIA's Gas Industry Operations quarterly report for third quarter of 1979. It equals approximately $1.85 per million Btu.

The price of fuel oil observed in that area No. 6 oil currently is approximately $2.47. I do not recall I ever used the figure $2.40.

Finally, by contrast, the posted price, the official April price ceiling for the state of Iowa was published on March 20, 1980, at $3.01, later reduced a few days ago to $2.73. Both postings are well in excess of not only the going price of No. 6 oil in that State, but the price of natural gas that these industrial users in Iowa would have experienced under ruling prices.

Thank you, Mr. Chairman. That is the reason why we indicate that this switch occurred strictly for—and for no other reason—because of the existence of phase I incremental pricing.

Mr. Braun. The reason the switch occurred is because of an incorrect posting. If you can buy oil for less than the posting, then the posting is incorrect?

Mr. Schlesinger. I would like to respond to that. Theoretically, there is absolutely no reason why, if the price of gas is in a perfect world to be geared to a posting which perfectly represents the price of No. 6 out in the field, theoretically, two standard deviations below the average observed price in a given State, theoretically, there is no reason why anyone would want to use No. 6 oil because the gas always would be below that.

I would submit there is no way other than a free market system operating as we are proposing for these phase II users that this can be accomplished.

Mr. Dingell. We had testimony a little earlier today that gas prices, to the city gate, on the average, is $2.19. How can this fellow be getting gas at $1.85—if that is true, that is about a 35 cent difference?

Mr. Schlesinger. What period of time was that price?

Mr. Dingell. I assume it is current. This figure was November 1979. I assume that is approximate for May.

Mr. Schlesinger. What location was that?

Mr. Dingell. National average was $2.19.

Mr. Schlesinger. In November?

Mr. Dingell. How are these folks getting it at $1.85 at approximately the same time? Your figures are April 2, which is 6 months later than November. How are they getting that gas at $1.85 and why and what kind of gas is it?

Mr. Schroer. I think there are a lot of price variables, not only by region, but within your contract structure. You are largely on a take or pay. Our particular 75 percent take or pay contract demands——

Mr. Dingell. What does take or pay have to do with that?

Mr. Schroer. It has to do with what the cost of our gas is and that is reflected in the cost to our customers. What I am saying is the higher load factor that a company operates at and the larger the contract volume in terms of its own pipeline contract can account for wide variation between companies as well as wide variation between regions.

Mr. Dingell. You are telling me this is due to take or pay contract?

Mr. Schroer. I am telling you it reflects their contracting pattern and their purse and I don't pretend to be expert on any company other than our own. But, I know it is one of the regions I am deeply concerned with maintaining a high load factor, so we don't have to turn backs under those contracts to where we keep our unit cost down.

Mr. Dingell. This was dump gas, wasn't it?

Mr. Davis. No, it wasn't.

Mr. Dingell. $1.85 gas in today's market is not dumped gas? Iowa Power & Light is a distributor, is it not?

Mr. Davis. In that market area, yes.

Mr. Dingell. What would Iowa Power & Light pay for its gas from the pipeline?

Mr. Davis. That is not the market that my company services. Iowa Power & Light is one of our customers, but this was not ours. I want to clear the point. You quoted an average nationwide price.

Mr. Dingell. I quoted Mr. Gooch.

Mr. Davis. The price he was quoted was represented as an average price nationwide?

Mr. Dingell. I can assume—what is the average price?

Mr. Davis. $2.32.

Mr. Dingell. That is a bigger difference. He said $2.19.

Mr. Davis. That means some will be higher than $2.32. Some will be lower. That is a lower price.

Mr. Dingell. I was not aware it is 47 cents here. How is it they were getting gas for a price that is 47 cents lower than average?

Mr. Davis. This is an old system. They probably have a large mix of old contract gas that is cheaper. A lesser portion of new expensive gas.

Mr. Dingell. What do you figure their rate would be to a residential customer?

Mr. Davis. I could not say. It is not my market.

Mr. Schlesinger. According to the same statistics from which $1.85 was taken, this represents the third quarter 1979 price of gas average to industry in the west, north central region in which Iowa is included. During that same period of time, the residential price was $3.18.

Mr. Dingell. Residential users pay $3.18 and those guys get it for $1.85?

Mr. Schlesinger. That may have been the cost of delivery.

Mr. Dingell. What does an industrial user get then?

Mr. Davis. Mr. Chairman, I think there is a good point here. Iowa Power serves Des Moines. Northern Natural also services markets as far away as Minneapolis and the rates are going to vary throughout the market territory.

Mr. Dingell. Iowa Power & Light gets their gas from where?

Mr. Davis. This gas is referred to as Northern Natural.

Mr. Dingell. Where does Northern Natural make its sales to, distribution to?

Mr. Davis. All along the pipeline system from the panhandle to Minneapolis.

Mr. Dingell. What are the prices in this particular area by Northern Natural?

Mr. Davis. I could not say.

Mr. Schlesinger. The price of gas in Northern Natural service territory?

Mr. Dingell. To Iowa Power & Light, are they $1.85?

Mr. Schlesinger. The price of gas from Northern Natural to Iowa Power & Light, I cannot answer that.

Mr. Dingell. Would it be above or below $1.85?

Mr. Lawrence. It would be above it.

Mr. Dingell. Then, why is this company getting it at $1.85 and other industrial purchasers are not paying $1.85?

Mr. Lawrence. That is the cost of service determination of Iowa Public Service Commission based on——

Mr. Dingell. Would this be an interruptible sale?

Mr. Davis. I don't know this, but I don't think they have interruptible sales on their market.

Mr. Dingell. Do you know so?

Mr. Davis. I don't know so.

Mr. Dingell. Would a 47-cent differential in price indicate to you that it was an interruptible sale?

Mr. Davis. I don't know.

Mr. Dingell. How about you, Mr. Lawrence? A 50-cent differential between an ordinary industrial purchaser and another industrial purchaser. The fellow who is getting it 47 cents less than the regular industrial price would have to be an interruptible purchaser, would he not?

Mr. Lawrence. No. The answer is "No." As we said, industrial price of $2.30, some are above and some below. This is below.

Mr. Dingell. Can you deny that he would be an interruptible purchaser?

Mr. Lawrence. I cannot, but I can also state it means he does not have to be one. Like Mr. Davis is saying, from what we think we know about the Northern system, they have a lot of storage and most of their customers are not interruptible.

Mr. Dingell. What is the price differential between an interruptible purchaser and a regular firm industrial purchaser?

Mr. Lawrence. That varies widely, but perhaps——

Mr. Schroer. I would like to help on that, but we don't have any interruptible customers any more, so I cannot answer that.

Mr. Dingell. What would it be in your knowledge?

Mr. Schroer. I remember historically it was all over the place. For instance, before the sovereign, in his wisdom, got into the market and created a gas shortage, we used to have a lot of interruptible gas. At that time, we priced it at whatever we could get over our purchase cost.

Mr. Dingell. If we want a take or pay contract, it would be below, wouldn't it? It was a question then of how much you were going to lose if it was take or pay.

Mr. Schroer. Our system in the early——

Mr. Dingell. Let me ask you this. How can you explain the 47-cent differential to this fellow below the average price for industrial purchasers in that area?

Mr. Schroer. I don't know that that is a fact and I don't think you do either.

Mr. Dingell. I am taking your average and we are reasoning together.

Mr. Schroer. I have trouble with the answer.

Mr. Dingell. How would you explain that?

Mr. Lawrence. They have a big mix of low contract sales. The overall price along the system is lower than the national average.

Mr. Dingell. It is 47 cents lower? Doesn't that strike you as being a rather large differential?

Mr. Lawrence. I think that was a decision by Iowa Public Service Commission on how to balance the tariffs based on cost of service to that particular customer and how much they were going to permit it to subsidize residential users. In virtually every case, they subsidize residential cost of service.

Mr. Dingell. Is a sale that is below cost, a sale that is related to cost of service?

Mr. Lawrence. I don't think this industrial sale would be made below the purchase cost of gas. I don't think it would be made below the commodity component of the tariff.

Mr. Dingell. I thought you indicated it was a good chance that it was.

Mr. Lawrence. No. I certainly don't think I did.

Mr. Dingell. Gas, at this particular time on new contracts, was going for what, new contracts at this particular time?

Mr. Lawrence. New contracts on short range of $2.30.

Mr. Dingell. So, here you have an industrial sale who is getting their gas at $1.85 when new contracts are going at $3.40?

Mr. Lawrence. I think the controlling factor is the overall purchase gas cost of the pipeline system which is more in the range of a dollar. That is close to national average of purchase gas.

Mr. Dingell. But, you have $2.40 plus the fact that you also have got transportation costs, don't you? They buy the gas in the gas patch and transport it in. What does transportation cost from the particular pipeline from where they buy the gas and where they make the sale?

Mr. Davis. Transportation costs would vary company to company.

Mr. Dingell. Approximately?

Mr. Davis. This is again an old system.

Mr. Dingell. Are you talking about the pipeline or Iowa Power & Light?

Mr. Davis. The pipeline. My guess would be that their transportation costs would be relatively below.

Mr. Dingell. How much?

Mr. Davis. I couldn't give you a precise number. All we are doing is speculating.

Mr. Dingell. But, I am sure finding out things while we are speculating. I am finding that we better take a better look at incremental pricing than we have been doing, particularly on the basis of your figures.

Well, gentlemen, you have been very patient. We have all had a good time. I hope that you will take a look at these figures. They raised almost as many questions as they answered. We thank you.

The subcommittee is adjourned. The Chair does announce we will be having additional hearings on incremental pricing and we will have additional witnesses to appear before the subcommittee to give us their views on this matter.

[The following correspondence was submitted for the record:]

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON ENERGY AND POWER
OF THE
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
WASHINGTON, D.C. 20515

April 10, 1980

Dr. Lincoln Moses
Administrator
Energy Information Administration
12th and Pennsylvania Avenue, N.W.
Room 4311
Washington, D.C. 20461

Dear Dr. Moses:

At a recent hearing held by this Subcommittee on the Phase II implementation of the incremental pricing provisions of the Natural Gas Policy Act of 1978 (NGPA) several witnesses complained of the frequent serious errors in the compilations by the Energy Information Administration of the price of high sulfur No. 6 fuel oil in the 48 contiguous states for April 1980. As you know, these figures are important inputs to the Federal Energy Regulatory Commission in their process of establishing incremental pricing ceilings under the NGPA.

In order for the Congress to act on the possible Phase II ruling from FERC, we must have reliable fuel oil price data. Please provide a detailed description of the process by which EIA complies these data and a full explanation for the April 1980 errors. If there are fundamental reasons why errors enter the process, these should be explained completely. We will need this information well in advance of our consideration of the formal Phase II rule early in May. Therefore, please provide the necessary information no later than April 25, 1980.

Should you have any questions, contact either Michael Woo or Paul Basile of the Subcommittee staff at 225-1030.

Sincerely,

John D. Dingell
Chairman

JDD/Blc

THIS STATIONERY PRINTED ON PAPER MADE WITH RECYCLED FIBERS

RECEIVED
MAY 8 1980
SUBCOMMITTEE ON ENERGY & POWER

Department of Energy
Washington, D.C. 20461

APR 2[illegible] 1980

Mr. John D. Dingell
Chairman
Subcommittee on Energy and Power
Committee on Interstate and
Foreign Commerce
House of Representatives
Washington, D.C. 20515

Dear Mr. Dingell:

Thank you for your letter of April 10, 1980, concerning the collection of data and the publication of alternative fuel price ceilings to support Title II of the Natural Gas Policy Act of 1978. In an effort to provide your subcommittee with the information it requires to effectively carry out its objectives, members of the Energy Information Administration (EIA) staff, responsible for supporting the Federal Energy Regulatory Commission in this task, will meet with Mr. Michael Woo on April 23, 1980, to discuss the subcommittee's requirements.

EIA feels this is the most efficient method in which to address the subcommittee's specific needs for information on a complex topic such as alternative fuel price ceilings. This approach should provide the subcommittee with the necessary data and background information it requires within your specified time frame. EIA will, of course, provide the subcommittee with a written response by May 2, 1980.

Should you have any additional questions, please call Ken Brown of my staff on 633-9053.

Sincerely,

Lillian Regelson

Lillian Regelson
Assistant Administrator
Energy Systems Support
Energy Information Administration

Department of Energy
Washington, D.C. 20461

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MAY 1 1980
SUBCOMMITTEE ON ENERGY & POWER

MAY 7 1980

Honorable John D. Dingell
Chairman
Subcommittee on Energy and Power
Committee on Interstate and
  Foreign Commerce
House of Representatives
Washington, D.C. 20515

Dear Mr. Dingell:

I share the concern you expressed in your letter of April 10, 1980, regarding Alternate Fuel Ceiling prices based on high sulfur No. 6 fuel oil. It is important that the Energy Information Administration (EIA) makes clear its basis for publishing these prices and the reasons why the prices are not always completely successful in meeting Congressional objectives. These ceiling prices are established to implement Section 204(e) of the Natural Gas Policy Act of 1978 (NGPA). As you are aware, the intent is for the prices to be set as high as possible without causing industry to change to burning oil as an alternative to gas.

The Federal Energy Regulatory Commission (FERC) promulgated regulations which require that each month's price be set at a level based on data collected, analyzed, and published by EIA. The analysis includes a computation, established by FERC, which is intended to set prices at the low end of the range of reported prices.

The data used to compute the alternative price ceilings are collected on a monthly basis from all identified sellers of high sulfur content No. 6 fuel oil to ultimate consumers. The data are due by the twentieth of the month following the close of the month in which the transactions occurred; the price ceilings are published for each State, by the twentieth of the following month. Thus, by February 20, 1980, EIA had received data concerning prices in January. By March 14, 1980, these data were compiled and used as a basis for prices published March 20, 1980, to set ceiling prices for April.

Two fundamental problems have emerged with this approach. The first problem is a consequence of sparse data, while the second results when there are rapid price changes. In several States sales of high sulfur residual fuel oil are infrequent.

In eight States there have been no reported sales for at least 1 month since we began collecting fuel oil data. In 21 additional States the market occasionally is dominated by a single supplier, and it becomes necessary to avoid disclosure of firm specific data which could cause competitive harm. These considerations have made it necessary to estimate the prices for low data States by using regional data, data from previous months, or both. There is no single, standard method which gives a best estimate for prices in these cases. Subsequent changes by EIA improve the estimates by taking information from the State reports for the most recent months to compensate for small numbers of reports and sales during the current month.

The second fundamental problem comes about because we publish numbers based on past data which are used to set future prices. EIA uses a method for estimating price changes from the month of data collection to a period just before publication on the basis of information in Platt's Oilgram Price Report. This method, however, will not compensate for price changes which occur after about 3 weeks before the month for which prices are set. When there is a rapid drop in prices at the end of the month, as there was in March, the EIA published prices cannot reflect this drop. In late March, FERC took regulatory action to publish lower prices in order to minimize fuel-switching. I believe that this type of action, based on policy judgment rather than data, is more appropriately taken by FERC than by EIA.

We are exploring the possibility of providing FERC each month with a forecast of prices in the following month. When we make forecasts we do not provide a single price; rather we make estimates for likely situations. Thus, FERC would be given a range of prices, from which they would establish Alternate Fuel Ceilings. We are not yet sure how well this sort of approach can be made to work. One of the problems we face in deciding how to set up forecasts is that suppliers of residual oil can make decisions on prices after the Alternative Fuel Ceiling prices are published; if these suppliers wish to do so, they can price the oil low enough to make fuel switching economically desirable to their prospective customers.

Along the same lines, a large industrial user is free to purchase residual fuel in a neighboring State or on the international market, which may have a lower price than the prevailing oil market in his State. For example, a company located on the Great Lakes might purchase residual fuel oil from Canada or some lower price State and transport it to its plant. This transaction would not be considered a delivered sale and hence would not be included in our data.

I hope this brief explanation coupled with the conversation my staff had with Mr. Paul Basile and Mr. Michael Woo, of your staff, are sufficient to assist you in the consideration of Phase II rulings on this subject.

Please contact Kendrick Brown, of my staff, on 633-9710, if further information or explanation is required on this matter.

Sincerely,

(Signed) Lincoln E. Moses

Lincoln E. Moses
Administrator
Energy Information Administration

House of Representatives,
Subcommittee on Energy and Power,
Committee on Interstate and Foreign Commerce,
Washington, D.C., April 21, 1980.

Mr. Christian De Guigne III,
Chairman Emeritus,
Stauffer Chemical Co., Westport, Conn.

Dear Mr. De Guigne: The Subcommittee on Energy and Power is currently considering the Federal Energy Regulatory Commission's (FERC) implementation of the incremental pricing provisions of the Natural Gas Policy Act of 1978. On April 3, 1980, the Subcommittee held a hearing on incremental pricing.

At the hearing, the American Gas Association (AGA) submitted a list (enclosed) which indicated that Phase One of FERC's incremental pricing program caused your firm to substitute the use of oil for natural gas. It would be helpful to the Subcommittee if you would comment on the reasons for and the circumstances surrounding your firm's reported decision to convert from gas use to oil use.

Enclosed is a brief description of Phase One of incremental pricing and a list of questions which can be used to form your response. If any questions arise, please contact William Braun or Michael Woo of the Subcommittee staff at (202) 225-1030. We would appreciate your response by May 2, 1980.

Sincerely,

John D. Dingell, *Chairman.*

Enclosure.

Description of Phase One

Incremental pricing allocates a portion of the cost of new gas supplies to industrial uses. Phase One, which started on January 1, 1980, allocates certain increased costs to large industrial facilities (over 300 Mcf per day) using interstate natural gas as a boiler fuel and sets a ceiling price below the price of high sulfur No. 6 fuel oil. (2 standard deviations below the average price of high sulfur No. 6 in the region.)

Questions

(1) Did your facilities actually convert from burning gas to burning oil?
(2) What were the reasons for the conversion?
(3) To what extent were the facilities subject to incremental pricing?
(4) Which fuel oil did the facilities convert to? (high sulfur No. 6, low sulfur No. 6, No. 2, etc.)
(5) What is the expected duration of the conversion?

[The above letter and enclosure was sent to the following persons: Henry Ford II, chairman, Ford Motor Co., Dearborn, Mich.; Richard J. Jacob, chairman of the board and chief executive officer, Dayco Corp., Dayton, Ohio; William Jeffrey, president, International Refining and Manufacturing Co., Evanston, Ill.; D. J. Krumm, president, treasurer, and chief executive officer, Maytag Co., Newton, Iowa; Raymond H. Herzog, chairman, Minnesota Mining and Manufacturing Co., St. Paul, Minn.; Charlton W. Hunter, president, GTE Automatic Electric Inc., Northlake, Ill.; Robert H. Malott, chairman, FMC Corp., Chicago, Ill.; L. L. Morgan, chairman and chief executive officer, Caterpillar Tractor Co., Peoria, Ill.; C. H. Murphy, Jr., chairman and chief executive officer, Murphy Oil Corp., El Dorado, Ark.; Charles J. Pilliod, Jr., chairman and chief executive officer, The Goodyear Tire and Rubber Co., Akron, Ohio; John H. Platts, chairman and chief executive officer, Whirlpool Corp., Benton Harbor, Mich.; Richard A. Riley, chairman and chief executive officer, Firestone Tire and Rubber Co., Akron, Ohio; Joseph L. Stewart, chairman, Armstrong Rubber Co., New Haven, Conn.; and Thomas P. Tatham, chairman of the board and president, Mid-America Oil & Gas, Inc., Houston, Tex. The responses to the letter follow:]

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MAY 5 1980

SUBCOMMITTEE ON ENERGY & POWER

to: BB
Woo

ARMSTRONG RUBBER COMPANY
500 SARGENT DRIVE
NEW HAVEN, CT 06507

JOSEPH L. STEWART
CHAIRMAN OF THE BOARD

April 29, 1980

The Honorable John D. Dingell, Chairman
Subcommittee on Energy and Power
Committee on Interstate & Foreign Commerce
Congress of the United States
House of Representatives - Room 3217 Annex No. 2
Washington, D C 20515

Dear Congressman Dingell:

We are happy to respond to the questions you asked in your letter dated April 21, 1980. I will respond directly to each question listed on page two of your letter:

Q. "Did your facility actually convert from burning gas to burning oil?"
A. Yes.

Q. "What were the reasons for the conversion?"
A. We switched from natural gas to fuel oil to reduce fuel oil storage cost and to use the fuel oil which was cheaper than the incrementally priced natural gas.

Q. "To what extent were the facilities subject to incremental pricing?"
A. Our Midwest Division, located in Des Moines, Iowa, was subjected to the provision of Phase I of the regulation.

Q. "Which fuel oil did the facilities convert to? (high sulfur No. 6, low sulfur No. 6, No. 2, etc.)"
A. This facility switched from natural gas to No. 6 fuel oil with 2% maximum sulfur content. This sulfur content is in compliance with State regulations.

Q. "What is the expected duration of the conversion?"
A. Our plan to reduce the volume of No. 6 fuel oil in storage is now almost complete. After the fuel oil inventory reduction is complete, we will then use the most competitively priced fuel.

Since the Subcommittee on Energy and Power is currently considering FERC implementation of the Natural Gas Policy Act, we would like to take this opportunity to state our views on the incremental pricing program. We believe that even though the intended purpose of the regulation was to protect residential users, our opinion remains that Title II will not accomplish its intended purpose. Our concerns remain as follows:

1. Incremental pricing is inflationary. Consumers have to pay increased prices for goods caused by increased operating costs.

2. Incremental pricing will encourage fuel switching from gas to oil by large industrials. Such switching would impose the utility operating costs on the remaining gas customers.

3. Natural Gas Policy Act should encourage the use of domestic energy to reduce our oil imports.

4. The tire and rubber industry must compete with foreign manufacturers for sales. The added burden of artificially inflated costs makes us less competitive.

5. The incremental pricing program is discriminatory in favor of the residential gas user and indirectly at the disfavor of the citizen who heats his home with oil. This discrimination should be eliminated.

I hope I have answered your questions adequately and that you will give consideration to our position on incremental pricing.

Sincerely,

J. L. Stewart

JLS:cb

CATERPILLAR TRACTOR CO.

Peoria, Illinois 61629

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MAY 9 1980
SUBCOMMITTEE ON ENERGY & POWER

May 5, 1980

The Honorable John D. Dingell
Chairman, Subcommittee on Energy and Power
House Interstate and Foreign Commerce Committee
Washington, D.C. 20515

Dear Chairman Dingell:

Thank you for your April 21, 1980, letter to Lee Morgan, chairman and chief executive officer, Caterpillar Tractor Co., requesting information on the impact of incremental pricing of natural gas on Caterpillar's energy supply decisions.

At the present time, there are no Caterpillar facilities that have switched from natural gas to oil as a result of incremental pricing. However, as the American Gas Association (AGA) list suggests, the Caterpillar Aurora, Illinois plant has moved away from natural gas to coal as its major energy source.

The following comments will place this conversion in perspective relative to incremental pricing.

In 1976, responding to uncertainties about national energy policy and about the reliability of long-term energy supplies, Caterpillar energy management undertook a conversion program to provide Aurora steam boilers with a multiple-fired capability to burn either natural gas, oil or coal. However, natural gas continued to be the prime energy source. In 1979, after discussions with Northern Illinois Gas Company regarding the impact of incremental pricing, the decision was made to switch from natural gas to coal. Preliminary cost analyses indicated the use of low-sulfur Kentucky coal would provide an adequate energy supply at a cost savings of approximately $.50/mm BTU. Since January, 1980 coal has been the principal energy source for boilers at our Aurora facility and will remain so for the foreseeable future.

In testimony presented to the Federal Energy Regulatory Commission on proposed Phase II incremental pricing, Caterpillar stated that escalating natural gas prices may force industrial customers to move to oil or coal as the major energy source. A copy of the statement is enclosed for your reference.

Caterpillar Tractor Co. supports repeal of Title II of the Natural Gas Policy Act. The world energy picture has changed drastically since 1978, resulting in unforeseen fluctuations in energy supply and price patterns for both the industrial and residential sectors of our economy. Incremental pricing will only serve to aggravate this situation further.

I hope this information is of assistance to you and your staff in your review of incremental pricing. Please let me know if we can be of further assistance.

Sincerely,

JW Welsh

JEWelsh
Energy Manager
Telephone: (309) 675-5496
alh

Enclosure

Firestone

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MAY 7 1980

SUBCOMMITTEE ON ENERGY & POWER

CHAIRMAN

May 1, 1980

Honorable John D. Dingell
Chairman
Subcommittee on Energy and Power
Committee on Interstate and Foreign Commerce
House of Representatives
Washington, D. C. 20515

Dear Congressman Dingell:

This has to do with your letter of April 21 and your questions concerning the reasons and circumstances surrounding our Company's decision to convert from gas use to oil use in our plant at Des Moines, Iowa.

1. Our facility at Des Moines did actually convert from burning gas to burning oil.
2. The reason for this conversion was economics. The cost of #6 high sulfur fuel oil dropped to $2.62 per million BTU's, which was more economical to burn than natural gas at $2.88 per million BTU's. I would add that since fuel oil burns with approximately 4% more efficiency than natural gas, fuel oil would be more economical to burn even if the price of natural gas were the same as oil.
3. According to our records, 98.8% of the natural gas used at Des Moines is subject to incremental pricing because it is used as boiler fuel. The balance is used for process fuel and is not subject to incremental gas pricing. Incidentally, the price of natural gas increased 52% in January 1980.
4. Our facility in Iowa converted to #6 high sulfur fuel oil.
5. Des Moines switched back to gas April 27, 1980 when the gas price was reduced to $2.31 per million BTU's.

If any additional information is needed, please advise and we will do our best to furnish it.

Sincerely,

R. A. Riley

R. A. Riley

THE FIRESTONE TIRE & RUBBER COMPANY · 1200 FIRESTONE PARKWAY

FMC Corporation

2000 Market Street
Philadelphia Pennsylvania 19103
(215) 299 6000

RECEIVED
MAY 1 9 1980
SUBCOMMITTEE ON ENERGY & POWER

FMC

TO: BB, Woo

May 15, 1980

Hon. John D. Dingell
House of Representatives
Subcommittee on Energy and Power
Room 3217
House Office Building Annex No. 2
Washington, D.C. 20515

Dear Congressman Dingell:

In response to your April 21, 1980 letter on incremental pricing provisons of the NGPA, FMC does have a facility on Northern Natural Gas Company's pipeline and it did switch from burning gas to burning oil on January 1, 1980. This facility switched from gas to oil because equivalent gas energy costs were higher than oil energy costs. Approximately 90% of the gas being consumed at this facility is subject to incremental pricing. We expect to continue burning high sulfur No. 6 oil until such time as the energy equivalent price of natural gas falls below the energy equivalent price of No. 6 fuel oil.

In reviewing your April 3, 1980 opening remarks before the Congressional Subcommittee on Energy and Power you said "Residential rates for natural gas have always been higher than industrial rates." seeming to imply that industrial consumers are "favored" over the residential class. Suppliers price goods to a particular customer on the basis of costs incurred to produce, package and distribute those goods for that particular class of customer. For example, the per pound cost of sugar purchased by bakeries is lower than the housewife's per pound cost because the cost to package and distribute the sugar to the bakery is lower. Your statement failed to point out the fact that distribution, billing and service costs for a gas distribution company servicing an industrial gas consumer are lower than those costs associated with servicing a residential gas consumer. Thus, it is reasonable that industrial customers pay a lower per unit cost for natural gas.

You also compared industrial gas cost and residential gas cost in the first and third quarters of 1979.(1) Your comparison showed residential rates rising faster than industrial rates and industrial consumption increasing. You were apparently implying that industrial customers are being favored with low rates and industrials are using too much natural gas.

Your comparison covers a very narrow time frame. Comparing cost and consumption data for four quarters in '78 and '79,(1) shows that average industrial gas cost increased 18.2% while average residential gas cost increased 14.8%. It also shows that industrial gas consumption decreased 6.8% while residential gas consumption increased 1.2% in the same period. Your comparison of first and third quarter gas consumption and costs could be misleading to those less knowledgeable about industrial gas use.

I recognize that as Chairman of the Subcommittee on Energy and Power you have significant interest in how increasing costs of natural gas will be allocated among residential and industrial consumers. The function of utility rate making is to allow the utility to recover the cost of meeting its service obligation in a fashion that is neither unduly discriminatory nor preferential. To depart from these principles to achieve other purposes, no matter how attractive those purposes may appear in themselves, seriously departs from the premise that service obligation is the basis for regulation. Once we depart from undiscriminatory and unpreferential natural gas rate making the possibility is introduced for setting gas rates for other purposes claimed to be worthwhile. When using gas rate regulation to achieve other purposes than recovering costs, it is difficult, if not impossible, to ascertain if those other purposes will be achieved, when they will be achieved, and what will be the impact on the customers and community at large. The concerns expressed in your letter about incremental pricing of natural gas causing industrial customers to fuel switch is an example of what can happen when natural gas rates are established on a basis other than utility cost recovery without discrimination or preference.

(1) Quarterly report of Gas Industry Operation. Published by American Gas Association, 1978 & 1979

I urge you to support gas utility rates based on the cost of service principle. It is an objective methodology which has served this country well. In this time of uncertainty lets not add more uncertainty by advocating gas rate designs which have not withstood the test of time.

If I may be of further assistance, please let me know.

Very truly yours,

A.P. Verret
Director, Energy

r41B4
KM61

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MAY 8 1980
SUBCOMMITTEE ON ENERGY & POWER

Herbert L. Misch
Vice President
Environmental and Safety Engineering

Ford Motor Company
The American Road
Dearborn, Michigan 48121

May 1, 1980

The Honorable John D. Dingell
Chairman, Subcommittee on Energy
and Power of the Committee on
Interstate and Foreign Commerce
House of Representatives
Washington, DC 20515

Dear Congressman Dingell:

Mr. Ford has asked me to respond to your letter of April 21 on conversion of Ford facilities from natural gas to fuel oil. Our answers to your questions, in the form requested, are attached.

Two Ford plants with existing capability for either natural gas or residual fuel oil are presently burning oil. In both cases, the switch was made to take advantage of a spot purchase of oil, offered at a price below the applicable natural gas rate:

- The assembly plant at St. Paul, Minnesota, referred to in the American Gas Association list, switched boiler fuel from natural gas to Number 6 fuel oil on March 3, 1980. The incremental gas price, set at the EIA estimate for high sulfur No. 6, was $3.25 per million Btu's in March and $3.15 in April. Actual Ford cost of No. 6 oil with less than 2% sulfur was $2.48 per million Btu's. Ford saved about $71,000 over the two months by using oil.

- The assembly plant at Kansas City, Missouri, switched boiler fuel from gas to No. 6 oil on April 7. Incremental gas price was $2.56 per million Btu's; No. 6 oil with less than 1.5% sulfur was $1.87. Savings through April were $17,500.

It is apparent that the EIA price posting system was unable to adjust to the normal spring drop in residual fuel oil price, perhaps exaggerated this year as suppliers attempted to eliminate excess inventories resulting from the mild winter. Improvement in this price posting system is needed, possibly including some flexibility for gas utilities themselves to adjust prices to meet competition. We point out, however, that interfuel competition among gas, oil and coal is desirable to exert downward pressure on the price of all three fuels, and elimination of that competition should not be an objective of the price posting system.

Sincerely,

H. L. Misch

H. L. Misch

Attachment

Questions

1. Did your facilities actually convert from burning gas to burning oil?

   A. Yes, we converted boilers at two assembly plants: one in St. Paul, Minnesota, in March and another in Kansas City, Missouri, in April.

2. What were the reasons for the conversions?

   A. To save almost $90,000.

3. To what extent were the facilities subject to incremental pricing?

   A. The boilers at both facilities are subject to incremental pricing.

4. Which fuel oil did the facilities convert to (high sulfur #6, low sulfur #6, #2, etc.)?

   A. Both are using #6 fuel oil: St. Paul less than 2% sulfur; Kansas City less than 1.5% sulfur.

5. What is the expected duration of the conversion?

   A. As long as #6 oil costs less than incrementally priced gas.

The Goodyear Tire & Rubber Company
Akron, Ohio 44316

RECEIVED
MAY 7 1980
SUBCOMMITTEE ON ENERGY & POWER

May 1, 1980

The Honorable John D Dingell
Chairman, Subcommittee on Energy and Power of the
Committee on Interstate and Foreign Commerce
Congress of the United States
House of Representatives
Washington, DC 20515

Dear Mr Dingell:

The following information is provided in response to the questions set forth in your letter of April 21, 1980 to Mr Charles J Pilliod, Jr.

1. Goodyear's boiler fuel facilities served by United Cities Gas Company and Cities Service Gas Company have been capable of burning gas and oil for a number of years prior to the promulgation of the Phase I rules. This alternate fuel capability was installed to insure continued plant operations during fuel supply disruptions.

   These facilities switched over to using fuel oil instead of gas during early March, 1980.

2. The switch from gas to fuel oil was made for economic reasons. Fuel oil offers more favorable economics under prevailing market conditions.

3. All boiler fuel usage of gas at these facilities is subject to incremental pricing under the Phase I regulations.

4. These facilities are now using high sulfur No. 6 fuel oil.

5. Fuel switching decisions are made monthly based on prevailing market conditions.

Very truly yours,

F R Tully
Director, Governmental Environment,
Safety and Health Assurance Programs

GIK/dsp

International Refining and Manufacturing Company
2117 Greenleaf Street
Evanston, Illinois 60202 U.S.A.
Developers and Manufacturers of Specialized Metal-Working Lubricants
(Area Code 312) 864-0256

April 25, 1980

Mr. William Braun
SUBCOMMITTEE ON ENERGY & POWER
ROOM 3217
House Office Bldg. Annex #2
Washington, D.C. 20515

Dear Mr. Braun:

With reference to your letter of April 21, 1980 and the Federal Energy Regulatory Commission's implementation of the incremental pricing provisions of the Natural Gas Policy Act of 1978, and the Subcommittee hearing on April 3, 1980 on incremental pricing, please note our firm has not substituted the use of oil for natural gas - we are not converting to oil.

Sincerely,

William Q. Jeffery
President

WOJ:pw

MAYTAG

May 2, 1980

The Honorable John D. Dingell, Chairman
House of Representatives
Subcommittee on Energy and Power of the
Committee on Interstate and Foreign Commerce
Washington, D.C. 20515

Dear Representative Dingell:

Mr. D. J. Krumm referred your letter of April 21, 1980, requesting certain information relating to incremental pricing to me for response.

With respect to your specific inquiry, our company switched from natural gas to high-sulfur (2 percent) No. 6 fuel oil for use in our boilers due to the fact that we could purchase fuel oil more cheaply than incrementally priced natural gas. All natural gas purchased for boiler use at our two main plants is subject to incremental pricing. Even though our conversion to fuel oil, in all likelihood, will continue as long as we can obtain fuel oil at a price below incrementally priced natural gas, we cannot be definite as to the expected duration of our conversion due to the uncertainties and problems associated with incremental pricing, as briefly discussed in our recent comments of April 23, 1980, to the Federal Energy Regulatory Commission (FERC), a copy of which is enclosed.

We appreciate the opportunity to respond to your inquiry and hope you find the above informative. We have been seriously concerned with the concept of incremental pricing of natural gas (Phases I and II). In comments which we submitted to FERC on January 31, 1980, regarding the proposed implementation of Phase II (copy enclosed), we noted that incremental pricing will force many industrial users to shift from natural gas to oil. This is now happening with respect to boiler fuel throughout Iowa and, as we have pointed out, the ultimate effect will be to increase residential gas bills.

We do not believe that the present situation can be rectified by more accurately setting the incremental price of natural gas below the market price for No. 6 fuel oil. Due to uncertainties created by the fact natural gas is

THE MAYTAG COMPANY / *Newton, Iowa 50208* / *Telephone 515-792-7000*

best copy available

subject to priority curtailment and by incremental pricing, many industrial users will elect or be forced to use fuel oil even with natural gas priced slightly less than oil.

In addition, the current situation of substantial numbers of large-volume industrial users switching from natural gas to oil for boiler users is but one example of the many difficulties inherent in the concept of incremental pricing, with the end-result being that incremental pricing will not accomplish the purposes for which it was intended.

We strongly urge that the Subcommittee recommend to the full Committee that the Phase II rule proposed by the FERC be vetoed and that the Subcommittee support legislative efforts to repeal the incremental pricing provisions of the Natural Gas Policy Act.

Sincerely,

SSwanger

S. O. Swanger
Vice President, Manufacturing

SOS/plc
Encs.

Stauffer Chemical Company
Westport, Connecticut 06880 / Tel. (203) 222-3000 / Cable "Stauchem"

April 30, 1980

The Honorable John D. Dingell
Chairman, Subcommittee on Energy and Power of
Committee on Interstate and Foreign Commerce
The United States House of Representatives
Washington, D. C. 20515

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MAY 5 1980
SUBCOMMITTEE ON ENERGY & POWER

Dear Mr. Dingell:

I am responding to your letter addressed to Mr. Christian de Guigne III regarding the American Gas Association's showing that our Chicago Heights, Illinois plant on the Northern Illinois Gas system had converted to an alternate fuel because of Phase I Incremental Pricing. This facility was fortunate in having a coal capable boiler which had been converted to gas a number of years ago to meet environmental regulations. To avoid the high cost of inflationary impact that would be imposed on the operation by Phase I Incremental Pricing, the boiler was abated and converted back to coal.

This will not be the case with the Phase II Incremental Pricing regulations being offered by FERC. Most industrial feedstock and process use of natural gas, including that at our Chicago Heights plant, cannot be converted to an alternate fuel. Our data shows an inability of the corporation to pass through to our customers all of the increase in energy cost since the Arab embargo of 1973-74. The recent round of increases in world oil price has exacerbated this situation. The abrupt increase in the price of natural gas to the price of fuel oil as proposed by FERC to implement Phase II Incremental Pricing could well force some segments of manufacturing out of business. In addition, Phase II will not serve the purpose for which it was intended, to protect the residential consumer from increased gas prices.

Incremental Pricing should not be applied to industrial feedstock and process use of natural gas. We urge you to veto the FERC proposal for Phase II Incremental Pricing. Enclosed is testimony supporting this position which was presented to FERC during these hearings.

If you have any questions, I would be happy to meet with you or members of your staff.

Very truly yours,

D. M. Greeno

D. M. Greeno
Vice President
Energy & Operating Services

DMG:eh

96th HRGS: Incremental Pricing Phase II

Whirlpool
CORPORATION

Public and Government Relations

ADMINISTRATIVE CENTER BENTON HARBOR, MICHIGAN 49022 (616) 926-5219

A.J. TAKACS
VICE PRESIDENT

TO: BB, Woo

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MAY 15 1980

SUBCOMMITTEE ON ENERGY & POWER

May 1, 1980

Honorable John Dingell
2221 Rayburn House Office Building
Washington D.C. 20510

Dear John:

This in reply to your letter of April 21, 1980, to Whirlpool Chairman, John H. Platts, requesting that we comment on our reasons for switching from natural gas to oil during the past few months. Whirlpool appreciates this opportunity to bring these facts to your attention and will briefly answer your list of questions.

Whirlpool Corporation is a major full line manufacturer of home appliances with nine manufacturing facilities located in six states. The American Gas Association list of those companies switching from gas to oil, which was submitted to the Energy and Power Subcommittee on April 3, 1980, included only our St. Paul, Minnesota, manufacturing facility which manufactures refrigeration equipment and vacuum cleaners.

It should be noted that the St. Paul Division is served by Northern Natural Gas Company under an interruptible contract. Historically, there have been in excess of 100 days per year during which gas supplies for boilers and process uses have been interrupted at this Division. Thus, the need for a convenient, reliable and cost-effective energy back-up system is critical. We have, therefore, installed alternate fuel capability which permits our boilers to be switched to high sulfur #6 oil in a matter of ten minutes or less. The Division purchases fuel oil from a local refiner of high sulfur #6 fuel oil who has consistently provided a reliable back-up supply of energy during natural gas interruptions.

As you know, this past winter was relatively mild in comparison with those of the last two to three years. Natural gas and oil supplies were plentiful. At our St. Paul Division, gas curtailments were less than expected during January and February.

The local refiner in St. Paul was faced during February with an inability to sell a substantial quantity of oil which had been stockpiled during the winter months. The local refiner offered this oil to our St. Paul Division and other industries at a price lower than that being charged for natural gas. The Division agreed to purchase and burn oil from this supplier in lieu of gas, not only because of the attractive pricing, but also to ensure the supplier's continued viability as a source of alternate fuel.

Although this decision is perhaps temporary, it was made on the basis of cost, business conditions and as a means of insuring continued, dependable supplies of alternative fuels. Similar decisions (to switch to oil) could be made for similar reasons during more severe winters. The very fact that natural gas supplies are interruptible makes oil back-up systems a sound business alternative.

Moreover, given the pricing structure of natural gas under Phase I to large industrial users, it is possible that comparable business circumstances will precipitate similar oil switching decisions from time to time at other manufacturing divisions.

The majority of Whirlpool's nine manufacturing facilities are subject to the Phase I incremental pricing program. Six of these nine facilities have an oil capability. Five of these facilities have installed capability to burn #2 fuel oil and one has the capability to burn #6 fuel oil. These facilities will not hesitate to burn oil when conditions make this choice either prudent, as could be the case when incrementally-priced natural gas exceeds the cost of oil, or necessary whenever curtailments of natural gas are imposed. Furthermore, the five facilities capable of utilizing #2 fuel oil could consider the comparatively inexpensive cost of converting to #6 fuel oil, given the right economic circumstances.

It is unfortunate that American industry must occasionally turn to the use of oil during a time of an intensive national effort to conserve or cut back on its usage. Artificial economic mechanisms, such as incremental pricing, will in many cases force industries concerned about the ultimate cost of their products to shift temporarily, or permanently, from natural gas to fuel oil when the latter source represents a less expensive alternative. We at Whirlpool deplore this situation, since we believe domestically produced natural gas should continue to be an integral part of industry's total energy mix.

Thank you for the opportunity to comment on this important issue of national concern.

Sincerely,

Andy

AT/lc

Purchasing/3M

3M Center
PO Box 33327
St. Paul, Minnesota 55133
612/733 1110
Telex 29 7023
TWX 910 563 3712

TO: BB, Woo

3M

RECEIVED
MAY 1[illegible] 1980
SUBCOMMITTEE ON ENERGY & POWER

May 6, 1980

Hon. John D. Dingell
Chairman
Subcommittee on Energy & Power
Committee On Interstate & Foreign Commerce
Room 3217
House Office Building Annex No. 2
U. S. House of Representatives
Washington, D. C. 20515

Dear Chairman Dingell:

Mr. Raymond Herzog has asked me to respond to your letter of April 21 requesting information about 3M's decision to convert from natural gas to oil use at some of our manufacturing plants.

Over the last four months, 3M has switched from natural gas to oil at four plants in the U. S. Permanent conversions were not necessary at any of these facilities since all four have a capacity to burn either fuel oil or natural gas. In each case the switch was made because the delivered price of fuel oil was below the Alternate Fuel Cost as published by the Energy Information Agency of the Department of Energy. In each case the switch was made to No. 6 high-sulfur oil. All boiler fuel used at these four facilities was subject to incremental pricing at the above mentioned Alternate Fuel Cost.

Since we currently have the capacity to burn either oil or natural gas at each of these plants, we expect to use whichever fuel is the least expensive at the time of delivery.

Sincerely,

Paul A. Johnson

Paul A. Johnson,
Director of Purchases
Operations

PAJ:feo

cc: R. H. Herzog

[Whereupon, at 2:50 p.m., the hearing adjourned, to reconvene at the call of the Chair.]

PHASE II INCREMENTAL PRICING OF NATURAL GAS

TUESDAY, MAY 6, 1980

House of Representatives,
Subcommittee on Energy and Power,
Committee on Interstate and Foreign Commerce,
Washington, D.C.

The subcommittee met at 2 p.m. in room 2123, Rayburn House Office Building, Hon. John D. Dingell, chairman, presiding.

Mr. Dingell. The subcommittee will come to order. Today the subcommittee is holding its second hearing on the subject of incremental pricing. Under the Natural Gas Policy Act of 1978, incremental pricing is to be implemented in two phases.

Phase I began on January 1 and applies only to large industrial facilities using natural gas as a boiler fuel. That provision set a ceiling price for those users at the price of high sulfur No. 6 fuel oil. Phase I is not subject to congressional review.

Phase II requires the Commission to decide what other industrial facilities should be included in the incremental pricing program. The Commission's preliminary decision for phase II was announced on March 20. On March 25, the Commission issued a summary of its preliminary decision, and the subcommittee held a hearing on the Commission's preliminary decision on April 3.

Today, the Commission issued and formally transmitted to the Congress its final decision implementing phase II of incremental pricing. The Commission's final decision is the same as the Commission's preliminary decision issued on March 20. The Commission's phase II decision includes all industrial users not exempted by the statute in the incremental pricing program, exempts the first 300 Mcf used each day, and sets the ceiling price at the price of high sulfur No. 6 fuel oil.

The Commission's final phase II rule is subject to congressional review and will become effective unless disapproved by either House of the Congress.

Today's hearing brings before us the Commission to present its final rule to the subcommittee. Following the hearing, the subcommittee will then be in a position to consider the resolution introduced by our good friend and colleague, Mr. Sharp, to disapprove the Commission's phase II rule.

As you know, under the Natural Gas Policy Act, the committee must operate under extremely limited time constraints with respect to this matter. As everyone knows, the resolution introduced by our good friend and colleague, Mr. Sharp, is House Resolution 655.

The Chair does welcome this afternoon the Honorable Charles B. Curtis, an old friend of the Chair and very distinguished public servant, together with Commissioners Hall, Holden, and Sheldon. Lady and gentlemen, we thank you for the courtesy you do us and we thank you also for being with us.

The Chair does wish, before I recognize first Mr. Brown and then Mr. Sharp, who is the sponsor of the resolution before us, to say to you, Mr. Curtis and the Commission, that I believe you have faithfully, fully, and properly carried out your responsibilities under the Natural Gas Policy Act. The Chair is keenly aware that you undertook a very difficult task and that you did it well—as you do all things well—at the mandate of the Congress.

So, we both commend you and your associates on the Commission for a job well done. We thank you for your assistance to us and commend you for the carrying out of the mandate of the Congress.

Without objection, the text of House Resolution 655 and Executive Communication 4310 will be printed in the record at this point.

[Testimony resumes on p. 363.]

[The text of H. Res. 655 and Executive Communication 4310 follow:]

IV

96TH CONGRESS
2D SESSION

H. RES. 655

Disapproving the proposed rule under section 202 of the Natural Gas Policy Act of 1978 (relating to incremental pricing) transmitted to the Congress on May 6, 1980.

IN THE HOUSE OF REPRESENTATIVES

MAY 6, 1980

Mr. SHARP (for himself, Mr. PREYER, Mr. ASHLEY, Mr. BROYHILL, Mr. BROWN of Ohio, and Mr. STOCKMAN) submitted the following resolution; which was referred to the Committee on Interstate and Foreign Commerce

---

RESOLUTION

Disapproving the proposed rule under section 202 of the Natural Gas Policy Act of 1978 (relating to incremental pricing) transmitted to the Congress on May 6, 1980.

Resolved, That the House of Representatives does not approve the proposed rule under section 202 of the Natural Gas Policy Act of 1978 (relating to incremental pricing of natural gas) a copy of which was transmitted to the Congress on May 6, 1980.

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

OFFICE OF THE CHAIRMAN

MAY 6 1980

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Honorable Thomas P. O'Neill, Jr.
Speaker of the House of Representatives
Washington, D.C. 20510

4310

Dear Mr. Speaker:

The Federal Energy Regulatory Commission has finalized regulations implementing Phase II of the incremental pricing program, as required by section 202 of the Natural Gas Policy Act of 1978 (NGPA). The statute requires that this rule be submitted to the Congress for review no later than 18 months after the date of enactment, by May 9, 1980. Either House may prevent the regulations from taking effect by adopting a resolution of disapproval within 30 legislative days.

The Phase II rule submitted herewith would extend the incremental pricing program to all industrial users except those specifically exempted by statute and set a uniform price ceiling for natural gas sold to industrial users subject to Phase II at the price of No. 6 high-sulphur residual fuel oil, but would exempt from incremental pricing the first 300 thousand cubic feet used each day by each facility for uses subject to Phase II.

As you know, the NGPA provides for phased deregulation of most newly discovered natural gas by 1985. The incremental pricing provisions, a program to transfer a larger proportion of the higher costs of new gas to industrial users, were included to partially shelter residential and other high priority users from the full immediate impact of higher gas costs and to mitigate potential disruption in the natural gas market following deregulation. The portion of new gas costs assigned to industrial users is to be limited by a ceiling price tied to the price of alternative fuels.

The statute requires that incremental pricing be implemented in two phases. Phase I applies to large industrial facilities using more than 300 thousand cubic feet per day of natural gas as a boiler fuel (to generate steam or electricity). The Commission implemented Phase I of the incremental pricing program on November 9, 1979.

An industrial user subject to incremental pricing is intended, under the statute, to pay up to the price of No. 2 distillate fuel oil. However, the Commission is given discretion to reduce the price ceiling to the regional price of No. 6 residual fuel oil in order to prevent industrial load loss. Industrial load loss of significant magnitude would lessen the protection from the higher costs of natural gas provided to residential users, one of the two stated objectives of the incremental pricing program. Under this authority, the Commission has adopted a three-tier system of price ceilings based on the regional prices of No. 2, No. 6 low-sulphur, and No. 6 high-sulphur fuel oil. The price to an individual facility is tied to the alternative fuel that the facility is actually equipped and authorized to burn.

The Commission submitted to the Congress an exemption under the authority provided in section 206(d) of the NGPA suspending the upper two tiers of the three-tier system for one year. The exemption was proposed to prevent industrial facilities from switching to fuel oil at the beginning of the winter heating season which might jeopardize supplies of home heating oil and to give the Energy Information Administration adequate time to implement a data collection program to determine the appropriate prices of all three grades of fuel oil. The Congress did not disapprove this partial exemption rule; it will remain in effect until November 1, 1980.

The average price per million Btu's for No. 6 high-sulphur fuel oil is now in in the range of $3.00 to $3.25, No. 6 low-sulphur sells for $4.00 to $4.50 and No. 2 is sold for approximately $5.50.

Section 202 of the NGPA requires the Commission to propose a Phase II rule "expanding [the] application [of the incremental pricing program] for other industrial uses." The Commission is granted broad discretion in determining the proper scope of the expansion. The Commission has determined that the purposes of the incremental pricing program would best be realized by extending the program to all industrial users other than those specifically exempted by statute, and that a broad Phase II rule would present the Congress with the meaningful choice seemingly required by the fact that Congress specifically reserved to itself the option to review and, if so determined, disapprove these regulations.

The Commission is proposing to set a single-tier price ceiling at the price of No. 6 high-sulphur fuel oil for Phase II users. This proposal is based on extensive public comment received in the course of a series of public hearings held throughout the country.

With this letter, the Federal Energy Regulatory Commission respectfully submits for Congressional review the regulations implementing Phase II of the incremental pricing program as required by section 202 of the Natural Gas Policy Act of 1978.

Sincerely,

Charles B. Curtis

Charles B. Curtis
Chairman

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

TITLE 18 - CONSERVATION OF POWER AND WATER RESOURCES

CHAPTER I - FEDERAL ENERGY REGULATORY COMMISSION

PART 282 - INCREMENTAL PRICING

(Docket No. RM80-10)

Rule Required Under Section 202 of the Natural Gas Policy Act

(Issued May 6, 1980)

AGENCY: Federal Energy Regulatory Commission

ACTION: Final Rule, Subject to Congressional Review

SUMMARY: The Federal Energy Regulatory Commission hereby adopts regulations in accord with the directive of section 202 of the Natural Gas Policy Act of 1978 (NGPA). The rule is subject to Congressional review and will not become effective if disapproved by either House of Congress. If not disapproved, the rule will expand the scope of the incremental pricing program to all industrial end-users not exempt under the NGPA, and provide that those users of natural gas other than as boiler fuel be permanently subject to incremental pricing surcharges up to the price of high-sulfur No. 6 fuel oil.

EFFECTIVE DATE: Such date as represents the ninety-first day following expiration of 30-day Congressional review period, if not disapproved by either House.

FOR FURTHER INFORMATION CONTACT: Alice Fernandez
Federal Energy Regulatory Commission
825 North Capitol Street, N.E.
Washington, D. C. 20426
(202)357-9095

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Charles B. Curtis, Chairman;
Georgiana Sheldon, Matthew Holden, Jr.,
and George R. Hall.

Rule Required Under)
Section 202 of the)
Natural Gas Policy) Docket No. RM80-10
Act of 1978)

ORDER NO. 80

FINAL RULE

(Issued May 6, 1980)

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I. Introduction.

Title II of the Natural Gas Policy Act of 1978 (NGPA) (Pub. L. 95-621) requires that the Federal Energy Regulatory Commission (the Commission) promulgate regulations to channel a specified portion of the increasing cost of natural gas to industrial users. The "incremental costs" of natural gas are to be passed through from interstate pipelines to industrial end users by means of a surcharge pricing mechanism.

Under Title II of the NGPA, the incremental pricing program is to be implemented in two phases. The first phase was implemented by regulations issued by the Commission on September 28, 1979 (44 FR 57726, October 5, 1979). 1/ Under those regulations, only large industrial facilties that use natural gas as a boiler fuel are subject to incremental pricing.

Section 202 of Title II requires the Commission to promulgate a second phase (Phase II) rule by May 9, 1980, that amends the

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1/ The regulations issued on September 28 were contained in two dockets, Docket Nos. RM79-14 and RM79-21.

scope of the incremental pricing program to include other industrial users. Specifically, subsection (b) of section 202 provides that the second phase rule:

> shall apply with respect to the industrial use of natural gas (as defined by the Commission in such rule), including boiler fuel use of natural gas...by --
>
> (1) any industrial boiler fuel facility....and
>
> (2) any industrial facility which is within a category defined by the Commission in such amendment as subject thereunder to the requirements of such rule which is not exempt under section 206.

Section 202 also directs the Commission to submit the Phase II rule to Congress, which has reserved the right to review and disapprove this rule if it decides against extending the scope of the incremental pricing program.

On November 15, 1979, the Commission issued a Notice of Proposed Rulemaking providing for a broad Phase II expansion of the incremental pricing program. 2/ This proposal derived from the Commission's review of the Congress' dual objectives in enacting the incremental pricing provisions. One objective is to prepare the natural gas market for deregulation in 1985. The second objective is to provide a measure of shelter to residential and other high priority customers from rising gas prices. The Commission then gave its preliminary view that "the Congressional purposes underlying incremental pricing would be most fully met if all industrial users, other than those specifically excluded by statute, are brought within the scope of Title II." (mimeo, p.5)

2/ Docket No. RM80-10; 44 FR 67170 (November 23, 1979).

In the Phase II Notice, the Commission also proposed to apply the "three-tier" system for determining the alternative fuel ceiling, which was developed for Phase I, to Phase II as well. In addition, the surcharge or flow-through mechanism developed for Phase I was proposed for Phase II. The Commission sought comment on these basic features as well as on several subsidiary aspects of its Phase II proposal.

Public hearings were held on the Phase II proposal in San Francisco, Salt Lake City, Chicago, Louisville and Washington, D.C. during the month of January; nearly 400 written comments were received. 3/ Many fundamental questions were raised regarding both the specific features of the Commission's Phase II proposal and the ability of the overall incremental pricing program to fulfill its objectives. Those comments have played a major role in helping the Commission shape its Phase II submission to Congress. The final rule prescribed below responds in various ways to data, views, comments and criticisms of the rule proposed in the Commission's November 1979 Notice.

At the outset, the Commission wishes to point out that many comments suggested that it not develop any expansion of the program beyond what is already required by section 201 (Phase I). It was argued that the Congressional purposes underlying incremental pricing are misguided or that market conditions have so changed as to render the program inappropriate. The Commission

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3/ A full list of commenters is contained at Appendix A.

does not accept this suggestion. The Commission believes that it was neither requested nor authorized to second-guess the social and economic judgments that the Congress made in enacting Title II. The role of the Commission under Section 202 is more limited. Instead, the Commission is instructed to bring its technical expertise to bear on the design of a workable Phase II rule that can best advance the purposes set by the Congress. It is up to the Congress to decide whether this Phase II submittal meets adequately the social and economic goals of the incremental pricing program or, indeed, whether those goals are still appropriate.

By virtue of the very review procedures built into section 202, it seems clear that the Congress sought to have this Commission develop a meaningful Phase II rule. The Congress would not have a meaningful choice if the Commission were to offer no rule, or a very narrow rule, for its review. The Congress has reserved to itself the fundamental judgment as to whether an expansion of incremental pricing is consistent with current national priorities.

The Commission believes that this Phase II rule presents a meaningful choice to the Congress. It proposes to broaden the scope of the incremental pricing program. On the other hand, it responds to the substantial body of comments that have urged the Commission to take a careful approach to Phase II and its attendent economic impacts.

II. Summary of the Phase II Submittal.

The Phase II rule approved by the Commission and submitted to the Congress would extend the incremental pricing program to all industrial users except those exempted specifically by the statute and would apply to all industrial gas consumption exceeding 300 Mcf per day. It also sets a uniform price ceiling for natural gas sold to industrial users at the price of No. 6 high-sulfur residual fuel oil.

An essential feature of the Phase II rule is that non-boiler fuel industrial users will be subject to incremental pricing only with respect to levels of consumption exceeding 300 Mcf per day. Thus, a facility using 400 Mcf per day of Phase II (non-boiler) uses would have 100 Mcf per day subject to incremental surcharges. For an industrial facility using 380 Mcf per day of natural gas as boiler fuel (a Phase I user), the entire 380 Mcf per day is surcharged, pursuant to the statutory provisions for incremental pricing of boiler fuel.

Another feature of the Phase II rule is that it would give states discretion to limit the impact of Phase II on individual users in order to ease any serious transitional burden. If, during the first year, Phase II would result in a surcharge of more than 75 cents per Mcf to any user, the state regulating consumption of that gas may allocate that portion of the surcharge exceeding 75 cents to other incrementally priced gas users within the state.

Technically, the Phase II submission would apply to all industrial "uses" other than those specifically exempted by statute. Gas straddle plants, which extract liquids from the gas stream, would be covered only with respect to net "use", or consumption, of gas as a fuel.

The Commission also recommends to Congress that the three-tier alternative fuel price ceiling approach under Phase I be postponed another year, until November 1, 1981. This specific action is submitted to the Congress for review pursuant to the general exemption authority of section 206(d). If the Congress agrees to this one-year exemption from higher prices for Phase I users, all users under both Phases I and II will have the same No. 6 high sulfur fuel oil ceiling through October 1981.

By the end of 1983, the Commission will review the impact of the incremental pricing program and evaluate what, if any, further changes would best advance the purposes of the program. The results of this review will be reported to Congress.

The final Phase II rule promulgated here will be submitted to the Congress by May 9. Either House has the statutory authority to veto the submission during the subsequent 30-day review period. If not disapproved, the Phase II expansion of the incremental pricing program will take effect 90 days after the Congressional review period has ended.

III. Background of the Incremental Pricing Program.

The NGPA was enacted in 1978 to reform regulation of the natural gas industry and provide for phased deregulation of new natural gas. Title I of the NGPA establishes incentive price schedules for variously defined categories of gas. Title I replaced a system of cost-based rates under the Natural Gas Act of 1938, which reached only to sales of gas in interstate commerce. The wellhead price of natural gas produced and consumed in the same state (so-called intrastate gas) was not subject to the Natural Gas Act. The NGPA changed the system dramatically by setting higher wellhead prices than had previously been allowed, and by also extending Federal price controls to previously unregulated intrastate sales. The maximum lawful prices set by Congress were substantially in excess of then-prevailing cost-based nationwide rates that had been set by the Federal Power Commission as regulated price ceilings.

Under Title I, the price of "new" natural gas will be deregulated on January 1, 1985. New natural gas is defined as production from wells spudded (drilling commenced) on or after February 19, 1977, which are more than 2-1/2 miles from or 1000 feet deeper than the nearest old well. In addition, production from new development wells will be deregulated by 1987. Finally, NGPA price controls on most flowing intrastate gas will expire on January 1, 1985.

A. Objectives of Title II Incremental Pricing. Title II of the NGPA, the incremental pricing provisions, were included by the Congress for two reasons. First, incremental pricing is designed to mitigate any disruption of the natural gas market that might occur upon deregulation in 1985. Many members of Congress, particularly those opposing sudden deregulation, feared serious disruption if deregulation were to occur during a period of supply and demand imbalance. The relatively low price of gas remaining under controls after 1984 was seen as providing an effective "subsidy" to pipelines willing to pay higher than long-run market clearing prices for deregulated supplies. Congress sought to eliminate this possible incentive for interstate pipelines to bid excessively high prices by initially increasing the price of gas delivered to large, price sensitive industrial customers to a level equal to the cost of their alternative fuel. Under this regime, Congress anticipated that pipelines, whose revenues depend upon volumetric throughput, would seek to minimize further increases in the cost of gas that might occur upon deregulation, for fear that industrial demand for natural gas (and therefore throughput revenues) would decline.

A second purpose of the incremental pricing provisions of the NGPA is to shield high priority gas users, such as residential users, from some of the scheduled wellhead price increases allowed by Title I of the Act. This shielding effect is accomplished by channeling to industrial customers a greater than pro rata share of rising prices paid by pipelines. The increased recovery of costs from industrial users results in an offsetting reduction in gas costs recovered from high priority users.

B. Mechanics of Title II Incremental Pricing. The incremental pricing program consists of two sets of accounting rules. One set of rules relates to accumulation, at the pipeline level, of "incremental gas acquisition costs." The other set of rules allocates these incremental costs among industrial end users according to their "maximum surcharge absorption capability."

For each unit of gas purchased by an interstate pipeline, the incremental gas acquisition cost is defined as the price paid by the pipeline minus a statutorily prescribed "threshold price" applicable to that gas. If a pipeline buys one MMBtu (million Btu's, or roughly one thousand cubic feet at standard temperature and pressure) of NGPA section 102 (new) gas at the present May 1980 ceiling price of $2.45/MMBtu, it then subtracts the May 1980 incremental pricing threshold of $1.78/MMBtu, which leaves $.67/MMBtu to be placed into the incremental gas acquisition cost account. The $1.78/MMBtu of cost at or below the incremental pricing threshold is placed into the pipeline's purchased gas account and is borne equally by all users. But the $.67/MMBtu in the incremental gas acquisition account is specifically channelled to users subject to the incremental pricing program. The more high-priced gas a pipeline buys, the larger will be its incremental gas acquisition account.

At the same time that pipelines are computing monthly incremental gas acquisition costs, end users are computing their monthly maximum surcharge absorption capability (MSAC). A user's MSAC is defined as the estimated monthly consumption subject to incremental pricing multiplied by the difference between the applicable alternative fuel ceiling and its "base rate". The base rate is determined by the state or local agency having ratemaking responsibility for sales to industrial end users, and does not include the incremental pricing surcharge.

The overall incremental pricing program for a specific interstate pipeline then operates by comparing total incremental gas acquisition costs against aggregate MSACs. If aggregate MSAC's exceed the pipeline's total incremental gas acquisition cost, then the entire amount of those costs is recovered solely from incrementally priced customers. During the initial stage of incremental pricing, all pipeline gas acquisition costs at prices above the incremental pricing threshold are "loaded" onto industrial customers. It is as if industrial customer end-use rates reflect one wellhead price while rates to residential and other high priority customers reflect a lower wellhead price.

But it is unlikely that aggregate MSACs will permanently exceed incremental gas acquisition costs on any pipeline system. This is because the size of the incremental gas acquisition cost account tends to grow exponentially as both the amount of incrementally priced gas and the incremental costs associated with that gas will increase over time.

Eventually, the size of the incremental gas acquisition cost account will equal aggregate MSACs. At this point all incrementally priced users will be, by definition, at their alternative fuel price ceiling. Further increases in the incremental gas acquisition cost account would, if channeled to incrementally priced users, take them above their alternative fuel cost.

To avoid forcing these industrial customers above their alternative fuel cost and potentially driving them from the pipeline's natural gas system, both Title II and the Commission's regulations provide for "spillover" of incremental gas acquisition costs to all customers once incrementally priced users have all reached their alternative fuel ceilings. During this spillover stage, that portion of a pipeline's total incremental gas acquisition costs that exceeds its aggregate MSAC is placed into the system's purchased gas account and is recovered evenly from all customers.

These increases in pipeline purchased gas accounts due to spillover will normally be passed on to all users regardless of whether they are subject to incremental pricing. But when these general cost increases reach incrementally priced users, they increase those users' base rates and thereby reduce their incremental pricing surcharges by reducing the difference between their alternative fuel price ceiling and their base rate.

Accordingly, once spillover begins, further increases in a pipeline's purchased gas costs are effectively borne completely by its exempt (non-incrementally priced) users. This subsequent loading onto exempt users occurs because the incremental pricing program does not force industrial users above their alternative fuel ceilings. What happens during the spillover period is that each industrial user's MSAC and, therefore, its incremental pricing surcharge tend to erode due to increasing base rates. As far as incrementally priced users are concerned, further increases in pipeline gas acquisition costs reduce incremental pricing surcharges and MSAC's but do not increase the overall delivered price.

When viewed from the perspective of residential and other exempt users, spillover signals the start of a temporary period during which they must bear 100 percent of further increases in pipeline gas acquisition costs, even though they may represent only 75 or 80 percent of the pipeline's customers. After spillover begins, the system effectively "loads" purchased gas cost increases onto exempt users until aggregate MSACs of incrementally priced users reach zero. This is referred to as the "catch up" stage.

Finally, the third stage of Title II incremental pricing begins when aggregate MSACs diminish to zero. At that point the incremental pricing system ceases to have any direct effect on user prices. The price of gas to industrial users may rise above the alternative fuel ceiling, but only because the base rate has done so. With incremental pricing surcharges equal to zero, incremental pricing has fulfilled the purpose of easing into higher gas costs, and the historical system of rolled-in pricing to all users resumes.

C. The Phase I Incremental Pricing Program. Section 201 of Title II creates a mandatory incremental pricing program applicable to industrial boiler fuel users. The Commission's Phase I rules became effective on January 1, 1980.

The most difficult issue encountered by the Commission in developing its Phase I rules was deciding how to set the alternative fuel ceiling. The Commission recognized that too high an alternative fuel ceiling price could lead to inadvertent loss of industrial load. On the other hand, too low a ceiling price would render the program ineffective in shielding residential and other high priority customers from rising gas costs. These considerations led the Commission to adopt a three-tier alternative fuel ceiling approach.

Under the three-tier system, an industrial boiler fuel user's alternative fuel ceiling price may be based on the price of No. 2 distillate fuel oil, No. 6 low sulfur residual fuel oil, or No. 6 high sulfur residual fuel oil. These three grades of fuel oil represent a wide range of prices, with No. 2 fuel oil significantly more expensive than No. 6 low sulfur fuel oil, which, in turn, is more expensive than No. 6 high sulfur fuel oil. Each facility subject to Phase I would be permitted to use as its alternative fuel ceiling the lowest priced fuel oil that it has the physical capability and legal authority to burn. 4/ However, in order to give the Commission time to put the program into operation and to avoid excessive impacts on any facility, the Commission proposed, and the Congress acquiesced in, a one-year moratorium on the upper two tiers until November 1, 1980.

A majority of States have taken action in response to the Phase I incremental pricing program that may bear on the Phase II program as well. Specifically, States have altered their end use rate schedules to set the price of natural gas to non-exempt (incrementally priced) users at the alternative fuel cost as referenced in the Commission's regulations and published each month by the Energy Information Administration of the Department of Energy.

4/ Legal authority, in this case, refers primarily to applicable environmental restrictions.

Any State taking this action would "zero out" the entire maximum surcharge absorption capability of non-exempt users in the State and thereby eliminate all incremental pricing surcharges to these users. The effect of this act on on the part of any State is to cause the entirety of increased revenues collected from non-exempt users to remain within that State. This result is different from what would occur under the Commission's rules, which operate at the interstate level. Under federal incremental pricing, incremental surcharges paid by non-exempt users in one State would contribute to a reduction in the amount of purchased gas costs to be recovered from exempt users in all States served by the pipeline. So it is in the self-interest of a State which contains significant non-exempt industrial load to capture the increased revenues derived from those users for the sole benefit of exempt users within the State.

In a Notice of Proposed Rulemaking on Statewide exemptions from incremental pricing issued on December 21, 1979, the Commission responded to a number of inquiries as to the fairness and legality of this State action.

> In sum, the Commission believes that the Congress has already addressed and affirmed the substitution of State-level incremental pricing (through increased rates to non-exempt users) for incremental pricing at the interstate pipeline level. These considerations lead the Commission to a preliminary view that it should not, and legally cannot, prevent States from raising rates of non-exempt industrial users at or above the federally-prescribed and published alternative fuel cost. 5/

5/ Docket No. RM79-47, 45 FR 1081 (January 4, 1980).

The Commission has yet to take final action on this and other issues in the Statewide exemption proceeding.

D. Relationship of the Phase II Proposal to Phase I. The fundamental question that the Commission has addressed in its Phase II proceeding is whether the purposes of the incremental pricing program would be better advanced by a broader scope than is embodied in Phase I. The Commission's decision to propose a broad Phase II rule in its November 1979 Notice of Proposed Rulemaking originated from its view that an expansion would be consistent with both the market ordering and price shielding objectives of the program.

Phase I of incremental pricing covers approximately .8 to .9 Tcf, or 7 to 8 percent, of annual interstate volumes. One argument originally offered by the Commission for expanding the program is that Phase I by itself might prove incapable of providing sufficient demand restraint to achieve market ordering in 1985.

> Phase I users are among the lowest priority users of natural gas; if heavily curtailed, Phase I users would no longer be in a position to affect their pipelines' bidding decisions. Under such circumstances, demand restraint could be achieved only through measures applicable to users of higher priority than industrial boilers. (mimeo, p. 9)

With respect to the objective of price shielding, the Commission in its November Phase II Notice anticipated correctly that under Phase I the maximum surcharge absorption capability of industrial boiler fuel users would be less than the amount of purchased gas costs subject to incremental pricing as soon as the rule took effect. Because all industrial boiler fuel users subject to Phase I are now at No. 6 high sulfur alternative fuel ceiling prices, high priority users are currently receiving the full amount of price shielding to be derived from Phase I with its single alternative fuel price ceiling. With Phase I users paying surcharges that have averaged about $.25 per MMBtu over the past few months, the benefit to high priority users has been about 2.5 cents per Mcf. For a typical gas-heating household using 130 Mcf per year, the benefit is approximately $3.00 per year. The Commission believed that the Congress intended a greater measure of price shielding, and so proposed a broad expansion.

Against this background of the purposes and operation of the incremental pricing program, the following section describes both the major themes expressed in the comments received on the Commission's proposed Phase II rule as well as the Commission's reaction to those comments.

IV. Public Comments and Commission Findings on the Proposed Phase II Rule.

The Commission's Phase II Notice of Proposed Rulemaking has attracted considerable attention. The following discussion attempts to summarize the dominant themes contained in comments filed in this proceeding. The major themes deal with:

A. The timing of the Phase II Rule.
B. The scope of the Phase II Rule.
C. The alternative fuel price ceiling.
D. Market ordering.
E. Residential and other high priority price shielding.

A final section of this preamble, addressing economic impacts, also deals with a number of comments received on that issue.

Because of the number of comments, no attempt has been made to list in the text all those who commented on each theme. Instead, two or three comments representative of the many others will be cited. All comments and the major issues addressed by each are listed in Appendix A.

A. The Timing of the Phase II Rule. The Commission received many comments suggesting that it delay promulgation of its Phase II rule. The American Gas Association and Northern Petrochemical Company as well as others asserted as a threshold matter, that the Commission has the discretion to delay its Phase II rule. They noted that the Phase II rule under section 202 is, by its nature, merely an amendment to the Phase I rule under section 201. They also noted that section 201(a) provides for amendments to the section 201 rule "from time to time". They concluded that the section 202 rule is such an amendment and thus may be made from "time to time" and need not be issued by May 9, 1980. 6/

Many comments also suggested that the Commission should take a cautious approach, or, indeed, not implement Phase II at all. They suggested that Phase II is premature at this juncture and that further experience with Phase I as well as in-depth economic analyses are required for the Commission to make a reasoned decision on Phase II. Commenters such as Natural Gas Pipeline Company of America submitted that the Commission lacks sufficient data to make a decision now. They noted that 1985 estimated alternative fuel prices, market supply and demand, and other crucial factors are highly speculative at this time. Colorado Interstate Gas Company and others agreed and added their belief that there are so many other crucial incremental pricing rules pending, including small user, statewide, and agriculture exemptions, that the effects of Phase II are currently indeterminable.

Commenters' suggested schedules for implementing Phase II varied widely. Many simply suggested an indefinite delay. Mississippi Public Service Commission and Mississippi Valley Gas Company recommended indefinite delay and added that the Commission should rely on state regulation in the interim period. Others, including Congressman Tom Corcoran of Illinois, sought a delay until more information and experience is gained and all exemption

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6/ Ascard Inc., suggests that the constitutionality of section 202 is in doubt. Other forums are more appropriate for resolution of that question; the Commission's task is to carry out Congress' mandate.

rules are finalized. UGI Corporation urged a delay until the Department of Energy sends to Congress its PURPA section 306 report relating to end-use rate design for natural gas. Others were more specific and suggested delays from one up to ten years. Southern Nevada Industrial Customers suggested that the Commission promulgate the Phase II rule now but establish a much later effective date. Colorado Interstate Gas Company suggested that the Commission ask Congress for more time.

Other comments suggested various phased-in approaches. Ford Motor Company submitted that a phased-in approach with annual reviews will provide flexibility and avoid subjecting more companies to incremental pricing until large volumes of incrementally priced gas hit the market. Cast Metals Foundation suggested a gradual phasing-in at 20 percent of the affected industrials per year until all 100 percent are included in the program.

Few comments expressed favor towards an immediate rule expanding coverage. However, Congressman Dingell of Michigan and Boston Gas Company favored such an approach. Congressman Dingell stated five reasons why a Phase II rule is needed now: (1) industrials who wanted more gas supplies and are getting them now should pay their fair share for those supplies now; (2) industrials must be encouraged to conserve; (3) market disorders during the transition period before 1985 must be avoided; (4) businesses should be given time to plan for decontrol; and (5) the Commission should have the opportunity to fine-tune its program before 1985. Boston Gas made the point that the Commission may lack statutory authority to expand the program later on.

The Commission is sympathetic to suggestions that it defer Phase II. It would be desirable to have more knowledge and experience with incremental pricing before issuing a Phase II rule. But section 202, in the Commission's judgment, requires a rule to expand the program to industrial non-boiler fuel uses, and leaves no room for delay. It states:

> Not later than 18 months after the date of the enactment of this Act, the Commission shall, by rule, prescribe an amendment to the rule required under section 201 . . . (emphasis added)

Any expansion of incremental pricing to industrial uses other than boiler fuel requires that a rule be issued on or before May 9, 1980. If disapproved by Congress, provision is made for submitting other Phase II rules. However, a failure to act now may legally foreclose the possibility of a later expansion of the program's scope, should it be decided that such would be in order.

The Commission is not persuaded by the comments of the American Gas Association, Northern Petrochemical Company and others that there is discretion in the NGPA to delay and expand the scope by later rulemaking. To interpret section 202 in relation to section 201(a) in the manner suggested would obviate section 202. The Commission concludes that the language of section 201(a) authorizing amendments does not apply to amendments that seek to broaden the scope of the program, which are the sole consideration of section 202.

The section 202 rule is an amendment to the section 201 rule; but it is not the type of amendment contemplated by section 201(a). According to the Statement of Managers (page 96) section 201 "applies to industrial boiler fuel facilities only." Consequently, any amendment referred to in section 201(a) must relate to industrial boiler fuel use. In contrast, section 202 specifically relates to matters not covered by section 201. It calls for a single amendment to the section 201 rule and then only to add coverage to the rule. And section 206(d), which does permit certain amendments to the section 202 rule, only provides for exemptions to that which is already included.

Stated simply, the legislative scheme of Title II is that the Phase II rule delineates the maximum scope of the incremental pricing program. The Commission is of the opinion that once the Phase II rule is adopted, the scope of the incremental pricing program may be contracted but may not be expanded. It follows that in order to give Congress a meaningful Phase II option, the Commission must issue a Phase II rule by May 9, 1980, premised on the understanding that no statutory provision is made for a later expansion of that rule by the Commission.

The Commission must, therefore, act now, even in the face of acknowledged uncertainty, in order to carry out the Congressional intent that it be given a meaningful expansion of incremental pricing from boiler fuel to other industrial uses. A broad Phase II rule can always be followed by section 206(d) exemptions.

The Commission is also sympathetic to and has tried to respond to requests that all other statutorily required exemptions be finalized prior to making the Phase II rule effective.

Final rules implementing the mandatory small boiler and agricultural use exemptions are being issued simultaneously with this Phase II rule. But with respect to discretionary exemptions under section 206(d), the Commission is not yet in a position to commit to any broad exemption plan. The Commission is concerned that generic exemptions could become so numerous as to reduce the Phase II rule to a hollow shell. The only prudent course is to provide for the broadest possible program at this time. By doing so, in addition to preserving the scope of the program, the Commission will retain the opportunity to revise and adjust the program as knowledge and experience develop further. Furthermore, during the transition period before 1985, industry as a whole will be able to acclimate itself to scheduled deregulation. Thus, with this approach, a functioning incremental pricing program will be in place when deregulation occurs.

Accordingly, this Phase II rule applies to all industrial gas users. Because the Commission recognizes that industry must have an opportunity to gain an understanding of the Phase II rule and plan for its implementation, the effective date of the Phase II amendment shall be delayed to the maximum extent permitted by the Statute, which is 90 days after the Congressional review period has ended.

B. Scope of the Phase II Rule.

The Commission's Notice of Proposed Rulemaking proposed to bring all industrial users, other than those specifically excluded by statute and except for those users who consume small amounts of gas, within the scope of the incremental pricing rule. A majority of commenters urged the Commission not to expand the scope of incremental pricing beyond the existing Phase I rule. Most asserted that the proposed broad Phase II rule utilizing a three-tier alternative fuel price ceiling would have disastrous effects on the economy and on their particular industries. These commenters forecast increased inflation and unemployment, fuel switching leading to increased dependence on foreign oil, plant closings, and other effects harmful to industry in particular and the national economy in general. On the other hand, some commenters argued that these forecasts of economic doom were exaggerated and that a broad Phase II rule would best implement Congressional purposes.

Many of the commenters urged the Commission to adopt a liberal approach to granting exemptions from any final rule of broad applicability. Pacific Gas and Electric Company, GTE Products Corporation, and Johns-Manville Corporation, among many others, urged the Commission to exempt uses of natural gas for which no reasonably feasible alternative fuel oil capability exists. Some industrial processes require controlled temperatures or clean flame characteristics which, it is suggested, can be achieved only with natural gas. Many feedstock uses require the particular chemical characteristics of natural gas. Many commenters argued that because of an absence of alternative fuel capability, they are "captive" users unable to switch fuels regardless of price and unable to conserve significantly without reducing production. These users argued that application of incremental pricing to their operations would create economic hardship that would more than offset any direct benefit to exempt, high-priority users. Furthermore, some pointed out that most process and feedstock uses of natural gas are in fact defined as high-priority uses under Commission and state curtailment plans.

For similar reasons, several commenters, including Northern Illinois Gas Company, the American Iron Ore Association and Korf Industries, recommended that natural gas used for plant protection be exempt from incremental pricing. Ideal Basic Industries, Inc. urged the Commission to exempt gas use which is necessary for environmental or industrial safety reasons. Avery International suggested that gas used for mandated emission control devices should be exempt. Phelps Dodge Corporation argued that natural gas used as ignition fuel or for flame stabilization should be exempt. Milwaukee Solvay Coke Company urged the Commission to exempt gas used in mixtures of coke-oven gas.

Other commenters asserted that the national interest and economic considerations require that certain industries or classes of industries be exempt from incremental pricing. For example, Potters Industries, Inc. urged the Commission to exempt gas used to manufacture products which are particularly sensitive to competition from foreign imports. A joint comment from North Carolina concerns suggested that the Commission exempt all gas used to manufacture necessities such as food, clothing and shelter. Certain Teed Corporation urged an exemption for the insulation industry, the Cast Metals Foundation urged an exemption for the foundry industry, Sikes Corporation urged an exemption for the ceramic tile industry, the National Clay Pipe Institute urged the same for the clay pipe industry, Schenley Distillers, Inc. recommended an exemption for gas used in the production of anhydrous alcohol for gasohol, and Cabot Corporation urged an exemption for gas used to manufacture corrosion resistant alloys, high temperature alloys, and stainless steels. Other commenters made similar requests citing the national importance of their particular gas uses and the inability of their industries to pass on such cost increases as would occur should the Phase II rule be promulgated as proposed.

From the number and quality of the comments received in this proceeding, it is obvious that the asserted equities involved in determining the scope of Phase II are exceedingly complex. If the Commission were to exempt firms or industries without alternative fuel capability or on some other basis such as social need, national defense, or potential economic disadvantage, the exemptions would soon swallow the rule. To grant some of the requested exemptions and deny the rest could produce highly inequitable results. In order to provide Congress with a proposed rule that would significantly expand Phase I coverage, the Phase II rule must be broad in its application. The record indicates that any significant attempt by the Commission to fashion generic exemptions would be complex and inequitable and could eventually result in a hollow Phase II rule that adds relatively little expansion to the program.

The Commission is continuing to develop a meaningful yet equitable approach for the treatment of generic exemptions from the incremental pricing program. It is the Commission's belief that section 206(d) provides the primary statutory vehicle for granting relief in the form of full or partial exemptions. Any exemption granted pursuant to section 206(d) must undergo Congressional review prior to taking effect, and the Commission believes the Congress, by inclusion of the section 206(d) mechanism in the NGPA, expressed a preference for reviewing exemptions from the program. Thus, the Commission intends to restrict its use of its adjustment authority under section 502(c) of the NGPA. Section 502(c) adjustments will be granted only in those cases where the most special of special hardship can be demonstrated or where a unique set of circumstances unequivocably warrants relief from incremental pricing.

The Straddle Plant Group and several individual natural gas liquid separation facilities argued that the natural gas they purchase should not be subject to incremental pricing. They argued that Title II should not apply because they do not "use" or "consume" all the gas that they purchase. Of the total volume of natural gas which enters a separation plant, most leaves in the form of natural gas, some leaves in the form of natural gas liquids, and the rest is consumed in the process. For example, 100 MMBtu's of gas may enter a particular separation plant. After processing, the gas stream that exits the plant will typically contain 80 MMBtu's of gas. Fifteen MMBtu's may be extracted in the form of natural gas liquids. Only the 5 MMBtu's of natural gas which is consumed in the process is incrementally priced under the Phase II rule below. This is not the result of a partial exemption. In the above example, 80 MMBtu's were returned from the plant in the form of natural gas supplies. Fifteen MMBtu's were separated from the gas stream but remained as useful energy supplies in the form of propane, butane and other natural gas liquids. Because the separation plant actually *uses* only 5 MMBtu's of gas, only the 5 MMBtu's would be subject to incremental pricing under Title II.

Most commenters strongly urged the Commission to continue the exemption for small users of both boiler and non-boiler fuel. The permanent exemption for small boiler users required by section 206(a)(2) of the NGPA will be promulgated in Docket No. RM80-24. 7/ Also, a rule applicable to new, small boiler users will be adopted in Docket No. RM79-48. 8/

In the Notice of Proposed Rulemaking issued in this docket, the Commission proposed to exempt from incremental pricing those

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7/ *See* Notice of Proposed Rulemaking, Docket No. RM80-24 (March 6, 1980).

8/ *See* Notice of Proposed Rulemaking, Docket No. RM79-48 (September 28, 1979).

small users that did not consume more than an average of 300 Mcf per day (or the permanent threshold established in accordance with section 206(a)(2) of the NGPA, if lower) for non-boiler fuel use during any month commencing with May, 1980. Although the comments strongly supported this exemption, several commenters suggested modifications. Mississippi Valley Gas Company, Municipalities for Small Industrial Consumers, and Kyle Associates, among others, recommended that the threshold for the small non-boiler use exemption be set at 300 Mcf per day even if the threshold for the small boiler fuel use exemption is lower as a result of the 5 percent rule required by section 206(a)(2). Northern Natural Gas Company suggested that the small industrial's gas use be examined once a year to establish eligibility for the exemption on an annual basis. Under such a procedure, a small user would not lose its exemption if gas use for one month exceeded 300 Mcf per day because of seasonal variations or unanticipated peak requirements. Northern Illinois Gas Company noted that the small non-boiler use exemption as proposed drew a harsh line. An industrial that uses more than 300 Mcf of gas per day has all of its gas subject to incremental pricing surcharges whether it uses 301 or 100,000 Mcf of gas per day. However, an industrial facility that uses 299 Mcf of gas per day is totally exempt. To relieve this harsh effect, Northern Illinois Gas Company and Koppers Company, Inc. urged the Commission to adopt a rule which would exempt the first 300 Mcf per day of non-boiler use for all industrial facilities. The Commission finds considerable merit in this approach and has made it a part of the Phase II rule.

Under the rule adopted by this order, a facility whose Phase II non-boiler uses average 300 Mcf per day or less during any month is totally exempt from incremental pricing (with respect to Phase II use) for that month. If a facility's Phase II uses average more than 300 Mcf per day during a month, only those volumes consumed in excess of 300 Mcf per day are incrementally priced. Thus, a facility averaging 380 Mcf per day of nonboiler fuel use during a month would have 80 Mcf per day subject to incremental pricing surcharges.

The Commission believes that exempting the first 300 Mcf per day of monthly average use is a simple and equitable approach to the small non-boiler use exemption. Problems associated with establishing eligibility for the small user exemption as originally proposed are removed. A facility whose requirements fluctuate from month to month around the 300 Mcf per day level will face lower and more stable gas costs than would have been the case under the originally proposed small non-boiler use exemption. With the approach adopted herein, the impact of incremental pricing will, to a greater extent, be within the control of the small marginal user. For most facilities the increased costs should not be so high as to induce non-productive capital expenditures to install alternative fuel capability. Nevertheless, the increased cost of gas over the 300 Mcf per day average should provide an incentive for such a facility to conserve. The Commission believes that all of a user's natural gas consumption need not be incrementally priced to induce appropriate conservation efforts. Sufficient incentive exists if the marginal use is so priced.

In addition, the Phase II rule places a proportionally greater impact on large users. A facility that averages 2,000 Mcf per day of non-boiler use will have 85 percent of this gas incrementally priced; a facility that averges 600 Mcf per day of such use will have only 50 percent of the gas incrementally priced. Accordingly, the incentive to make conservation or conversion investments is greater for the large users who are more likely to find the absorption of such investments economically feasible.

Small user exemptions for boiler fuel use and non-boiler fuel use will be treated separately under an additive approach. Thus, a facility that in 1977 used an average of 250 Mcf per day as boiler fuel (Phase I use) and which uses an average of 400 Mcf per day in non-boiler (Phase II) applications would qualify for both small user exemptions. Only 100 Mcf per day of the Phase II non-boiler fuel use would be subject to incremental pricing surcharges.

The only industrial non-boiler use of natural gas falling within the potential scope of Phase II that is excluded specifically excluded from this Phase II rule is pipeline compressor fuel. The cost of natural gas used as compressor fuel is treated as a general pipeline expense, to be recovered evenly from all customers. Because pipelines would be allowed to pass along the full increased cost of compression if such fuel were incrementally priced, there is no likelihood that the market ordering objective of incremental pricing would be advanced by bringing pipeline compressor fuel within the scope of Phase II.

Concurrently, incrementally pricing pipeline compressor fuel will not contribute to residential and high priority price sheltering, because all customers would pay for the increased cost of compression. The purposes of Title II have, throughout the course of this proceeding, served as the Commission's guide. In the case of pipeline compressor fuel, this guide has led the Commission to the conclusion that incremental pricing should not be imposed.

The rules exempting agricultural uses from incremental pricing are being considered in separate dockets. 9/ Exempt agricultural use will not be considered in determining the 300 Mcf per day non-boiler use exemption established by this order. Thus if a facility uses an average of 900 Mcf per day in non-boiler applications, with 200 Mcf of this eligible for an agricultural exemption, the facility would pay surcharges on 400 Mcf per day. The exempt 500 Mcf per day would be comprised of the first 300 Mcf per day plus the 200 Mcf per day agricultural exemption.

9/ See Notice of Proposed Rulemakings, Docket Nos. RM80-28 and RM80-29 (45 FR 15563, March 11, 1980).

C. The Alternative Fuel Price Ceiling

In the Phase II Notice of Proposed Rulemaking the Commission proposed that the alternative fuel price ceiling to be applied to non-exempt industrial facilities subject to Phase II should be the same three-tier system of price ceilings that was adopted in Phase I of the incremental pricing program. However, as explained below, the Commission has determined that a three-tier alternative fuel price ceiling should not be adopted for Phase II. Instead, the Commission has adopted a single-tier alternative price ceiling based on the price of No. 6 high sulfur fuel oil.

Section 204(e) of the Natural Gas Policy Act requires that for both Phase I and Phase II, the Commission is to establish an alternative fuel price ceiling for incrementally priced industrial facilities. That ceiling is to be the price of No. 2 fuel oil unless the Commission determines that the ceiling price to an amount not lower than the price for No. 6 fuel oil. Generally speaking, the Commission may reduce the alternative fuel price ceiling below the level of the price for No. 2 fuel oil if such action is necessary to prevent industrial load loss that results in rate increases to high-priority customers. The Commission's specific authorization to reduce the alternative fuel price ceiling is set forth in section 204(e)(2):

> (2) REDUCTION OF APPROPRIATE ALTERNATIVE FUEL COST ALLOWED. - The Commission may, by rule or order, reduce the appropriate alternative fuel cost --
>
> (A) for any category of incrementally priced industrial facilities, subject to the rule required under section 201 (including any amendment under section 202 to such rule) located within any region and served by the same interstate pipeline; or
>
> (B) for any specific incrementally priced industrial facility which is subject to such requirements and which is located in any region;
>
> to an amount not lower than the price, per million Btu's, for Number 6 fuel oil determined by the Commission to be paid in such region by industrial users of such fuel, if and to the extent the Commission determines, after an opportunity for written and oral presentation of views, data, and arguments, that such reduction is necessary to prevent increases in the rates and charges to residential, small commercial, and other high-priority users of natural gas which would result from a reallocation of costs caused by the conversion of such industrial facility or facilities from natural gas to other fuels, which conversion is likely to occur if the level of the appropriate fuel cost were not so reduced.

In Phase I of the incremental pricing program, the Commission adopted a three-tier system of price ceilings as a means of balancing the objectives of maximizing the passthrough of "high price" gas costs to boiler fuel users and, on the other hand, preventing load shifting that would increase rates and charges to high-priority users. 10/ Under this system, regional prices for No. 2 fuel oil, low-sulfur No. 6 fuel oil , and high-sulfur No. 6 fuel oil are designated as ceilings on the price of gas for industrial boiler fuel users. The ceiling for a particular user is to be

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10/ Order No. 50, issued September 28, 1979.

equal to the price of the least expensive fuel oil that the customer has the installed capability and legal authority to burn.

At the same time that the Commission adopted the rule for a three-tier system of price ceilings, it also adopted an exemption to that rule. Pursuant to its authority under section 206(d) of the NGPA, the Commission determined that until November 1, 1980, a single price ceiling set at the high-sulfur No. 6 price level should be used. 11/ The Commission reasoned that a delay in implementing the three-tier system was necessary to permit industry an opportunity to adjust to the incremental pricing program. Also, it was determined that the delay would permit the Energy Information Administration, the organization with responsibility for gathering price data and computing price ceilings, to gain experience in meeting the incremental pricing data needs.

As required by section 206(d)(2) the exemptive rule was submitted to Congress for its review and possible one-House disapproval. Neither House disapproved the delay of the three-tier ceiling and the rule became effective December 1, 1979. In an order that is being issued concurrently with this Phase II rule, the Commission is submitting for Congressional review another rule under section 206(d) that would delay implementation of the three-tier ceiling for Phase I for an additional year.

11/ Order No. 51, issued September 28, 1979

For Phase II the Commission's Notice of Proposed Rulemaking provided that the three-tier ceiling approach adopted in Phase I be applied to an expanded incremental pricing program. In the Notice, the Commission explained that a three-tier system of price ceilings would maximize the recovery of incremental costs from a non-exempt facility but would also minimize the possibility that a facility will switch to an alternative fuel. In the Notice, the Commission also suggested that a price ceiling identical to that adopted in Phase I would impose the least administrative burden upon incrementally priced facilities.

Written comments and hearing statements submitted in response to the proposal to extend the three-tier system of price ceilings largely opposed its adoption. These comments argued that if incremental pricing is to be expanded to non-boiler fuel uses the price ceiling for facilities subject to Phase II should be no higher than the price for high-sulfur No. 6 fuel oil.

Two major themes supporting a single-tier No. 6 ceiling have emerged. First, many commenters, including AGA, INGAA, the National Association of Manufacturers and several state utility commissions, argued that a three-tier ceiling would cause economic dislocations among those users subject to a Phase II rule. Assuming the ceiling system were to include prices as high as No. 2 fuel oil as an alternative price ceiling, commenters argued, industrial load loss would occur on interstate systems as a consequence of the relocation of facilities using interstate gas that is subject to incremental pricing to intrastate markets where gas is not subject to incremental pricing. Also, many of those submitting comments, such as as Herman Energy Services and Sun Pac Foods, argued that if the incremental pricing program is expanded, a three-tier ceiling will exacerbate the competitive disadvantage of domestic industry relative to foreign industry. Other commenters forecasted that a three-tier system of price ceilings could cause some industrial facilities to burn imported fuel oil. And, finally, those who foresaw unfavorable economic impacts resulting from a three-tier system alleged that industrial facilities that currently lack the capability to burn No. 6 fuel oil will make unproductive investments by installing unneeded No. 6 fuel oil burning equipment solely for the purpose of qualifying for a lower alternative fuel price.

The second major theme argued by those opposed to the adoption of a three-tier ceiling is that such a system will produce inequitable results. Those commenters asserting this view noted that oil prices have increased dramatically since enactment of the NGPA and current prices for No. 6 fuel oil are now at the level that Congress expected for No. 2 fuel oil. Because of these circumstances, the comments argued that at a single-tier No. 6 ceiling, residential and other high-priority gas customers will benefit from price shielding at a level comparable to that envisioned by Congress in 1978. Any additional price shielding resulting from adoption of a three-tier approach will, according to these comments, mask the price of gas to high-priority customers and erode incentives to conserve gas. Moreover, these commenters argued that price shielding of high-priority gas consumers is inequitable to homeowners and others that do not have the capability to burn gas. Commenters advocating this point of view asserted that oil consumers who would otherwise qualify as high-priority users if they had the capability to use gas as their energy source, will be excluded from any price shielding following rapid cost increases. And, it is further alleged, all consumers will subsidize high-priority gas users because higher prices must be paid for those goods that are manufactured using incrementally priced gas. To temper these adverse consequences, these commenters urged the Commission to adopt a single-tier ceiling.

Not all those submitting comments, however, supported adoption of a single-tier, high-sulfur No. 6 ceiling. The Consumer Energy Council of America, the New York State Consumer Protection Board and other commenters urged the Commission to adopt and implement immediately the three-tier approach set forth in the Notice of Proposed Rulemaking. Others, such as the California and Wisconsin public utility commissions, urged the Commission to phase-in the three-tier approach over time or apply different ceiling prices to different gas users, such as a No. 2 ceiling for customers subject to a firm rate schedule and a No. 6 ceiling for the interruptible customers. Finally, other commenters, such as Mississippi Valley Gas and the North Carolina Utilities Commission, et. al., urged the Commission to adopt a fourth tier to recognize that there are gas users that cannot convert to fuel oil but must rely upon propane as an alternative fuel.

1. Single-Tier High Sulfur No. 6 Fuel Oil Ceiling for Phase II.

The Commission believes that many of the comments opposing a three-tier ceiling provide compelling reasons for adopting a single-tier high-sulfur No. 6 ceiling. Although the Congress made the fundamental determination that high-prioroity users should be shielded from the near-term adverse transitional effects of deregulation, it left it to this Commission to determine the level of the price ceiling. The only limitation is that the basis for the alternative fuel ceiling prescribed by the Commission must, pursuant to section 204(e)(2), be the prevention of load loss that will cause higher rates and charges to be levied upon high priority and other exempt users. The potential for this effect, as expressed by many commenters, has contributed to the Commission's choice of an alternative fuel price ceiling.

As indicated, many commenters representing a cross section of industrial gas users have stated that a three-tier ceiling presents the potential for severe industrial load loss. Assuming interstate pipelines were to experience such load loss, increased rates and charges to high-priority gas users could be accelerated as a result of the reallocation of fixed costs. This would not be a result intended by the Congress.

But, at the same time that the Commission acts to minimize industrial load loss, it must also advance another objective inherent in the NGPA. The Commission believes that Title II reflects a Congressional determination that non-exempt industrial users should be charged prices that more closely reflect the commodity value of gas. By charging industrial gas users a price closer to that of fuel oil -- the benchmark for determining the commodity value of gas -- the incremental pricing program recognizes that Federal natural gas regulatory policies have resulted in underpricing gas in relation to its commodity value. Current policy, as articulated by the NGPA, is designed to increase production and to discourage any excessive use of this premium energy source. The economic efficiency arguments made by industrial commenters who caution against artifically low prices to exempt users would seem to suggest that, at the very least, the price of gas to industrial users themselves be raised to the level contained in this Phase II rule.

While the NGPA compels some increase in industrial gas prices, the Commission's choice of an alternative fuel price ceiling should be based on a balancing of several policy objectives which include price shielding and the need to minimise industrial load loss.

The Commission judges that such a balance is best struck with a single-tier high-sulfur No. 6 fuel oil ceiling. In adopting this single-tier ceiling, the Commission notes the many comments emphasizing that the price of No. 2 oil has risen to such levels that, should the price of natural gas be forced to that level, the economic impact on industry would be so severe that in many instances it could not be absorbed and rates would be increased to exempt users. It is noteworthy that these same commenters anticipate the cost of gas could reach price equivalence with No. 2 fuel oil upon deregulation in 1985. It is the premature establishment of such prices by regulation rather than by the marketplace that appears most objectionable to industry.

The Commission also notes the substantial rise in oil prices since the NGPA was passed in 1978 and the particularly large increase in distillate fuel oil prices. Many commenters, including Stauffer Chemical, argued that these price movements will cause the effect of a No. 6 high-sulfur ceiling to be as substantial as the Congress intended when it passed the NGPA. 12/

12/ The prices of fuel oil have risen significantly since November 1978, when the NGPA was enacted. The following table summarizes changes that have occurred in delivered industrial prices. Figures are expressed in terms of price per million Btu's.

	November, 1978	Current *
No. 6 high sulfur	$1.73	$3.34
No. 6 low sulfur	$2.10	$3.97
No. 2	$3.10	$5.13 **
Natural gas	$1.75	$2.60

* Source: Monthly Energy Review, March 1980
** Wholesale heating oil

The adoption of a minimum commodity-value gas price for industry should also minimize, if not eliminate, the type of severe regional or international competitive disruption that was predicted in many industrial comments. For example, there is considerable doubt as to whether incremental pricing even at higher alternative fuel ceilings as were in the Commission's November Phase II proposal would lead to industrial relocation to intrastate markets. Industrial users may well confront higher delivered prices in intrastate markets after deregulation in 1985 because a greater fraction of intrastate gas will be deregulated at that time. So, an industrial user would experience at most a four-year gas cost advantage from such a move. A transitory benefit of this nature would be unlikely to induce significant industrial relocation.

In this order the Commission has determined that the scope of Phase II should be applied broadly to include all industrial gas users except those statutorily exempt. A study undertaken by DOE for purposes of commenting upon this rule suggests that a single-tier ceiling No. 6 fuel oil, applied broadly, will provide residential and commercial gas consumers a high degree of price shielding falling just short of maximum protection in 1984. Accordingly, a reasoned response to those comments that foresee industrial load loss is to adopt a high-sulfur No. 6 ceiling that can be expected to provide a significant degree of price shielding.

Furthermore, the Commission believes that for Phase II, the No. 6 ceiling is more equitable than a three-tier system of ceiling prices. A No. 6 ceiling responds to those comments that argued that it is inequitable for high-priority gas consumers to enjoy price shielding not available to those who must purchase oil to operate their homes and businesses. For residential and other exempt users of gas, it was the decision of Congress to provide a price shielding mechanism that is not available to those energy consumers that purchase and use oil.

A No. 6 alternative fuel ceiling also responds to the commenters that argued that it is inequitable for the general public to pay for those consumer goods which will allegedly bear higher prices caused when manufacturers pass on their incremental gas costs. The comments of the American Gas Association typified this argument. AGA argued that prices for many consumer goods would be increased by the incremental pricing program and that the effect of such price increases would be an accelerated rate of inflation. In a later section of this order, the Commission has more fully considered this argument and concluded that most, if not all, of the increased inflation foreseen by the AGA will not occur. In contrast to AGA's projections, commenters such as DOE and the Council on Wage and Price Stability suggest that competitive considerations would likely preclude the flow-through of a significant measure of increased gas costs. Also, AGA's analysis is premised on an econometric model that contemplates application of a three-tier ceiling. However, when considered together with the adoption of an exemption from incremental pricing for the first 300 Mcf of gas for all incrementally priced industrial facilities, the Commission's adoption of a single-tier ceiling should negate significant price increases for consumer goods.

The No. 6 ceiling adopted here also resolves two other concerns. Several commenters argued that many industrial facilities cannot use oil as an alternative fuel but must rely instead on propane as the alternative energy source. As indicated in the Notice of Proposed Rulemaking, such facilities would be priced at the level of No. 2 fuel oil, even though the price for propane is often closer to the price of residual fuel oil. By the action taken here, the Commission responds to these comments by adopting a single-tier high-sulfur No. 6 ceiling. Also, a high-sulfur No. 6 ceiling responds to the alleged inequity created as a result of pricing a facility at a No. 2 ceiling unless the facility has the capability to burn No. 6 fuel oil. All facilities subject to a Phase II rule will be priced at a high-sulfur No. 6 ceiling and, consequently, industrial facilities will not be constrained to buy and install equipment with the capacity to burn No. 6 fuel oil.

Finally, in applying the high-sulfur No. 6 ceiling, the Commission has determined that other aspects related to this ceiling approach should correspond to the previous Commission order that adopted a three-tier ceiling in Phase I. Thus, the Commission will request EIA to use the same method for computing the ceiling for Phase II as is used for computing the monthly ceilings for Phase I. Also, the Phase II ceiling will be applied to the 48 contiguous states and 31 metropolitan regions. However, until October 31, 1981, the regions will be limited to the 48 contiguous states.

2. State Authority to Limit First-Year Impacts

The Commission has also determined to provide a mechanism to limit the first-year impacts of the Phase II incremental pricing program. The effect of the Commission's determination could serve to lower the effective alternative fuel price ceiling for some facilities.

Under this mechanism, each state will be given the discretion during the first year of the Phase II incremental pricing program to allocate to other incrementally priced gas users within the state that portion of a non-exempt user's surcharge which exceeds an average of 75 cents per Mcf. In determining whether the surcharge to an industrial user exceeded an average of 75 cents, costs related to gas used for exempt purposes would be included in that determination.

In choosing the 75 cent threshold, the Commission is guided by the likely average cost increases to non-exempt users for the first year and, also, the Commission's judgment about when greater-than-expected incremental cost increases should be ameliorated. The Commission's best estimate is that the average first-year cost increase to Phase II users will average approximately 50 cents per Mcf. However, should oil prices rise significantly faster than anticipated, the first-year cost increases would be greater than expected. If the average cost increases were to increase to 75 cents per Mcf, or 50 percent more than currently anticipated, the Commission believes there would exist a sufficient basis upon which to take mitigating actions.

The mechanism provided here allows a state to assess independently the impact of incremental pricing upon individual industrial users within the state and determine whether a surcharge in excess of 75 cents presents too severe a burden upon that user.

During an informal conference held at the Commission on April 15, 1980, representatives from a number of state regulatory commissions expressed doubt that the authority to limit first-year impacts would be exercised. The representatives cited possible constraints in state laws against such adjustments. They also cited practical and policy considerations which might lead a state commission to decline to make use of any such adjustment authority. Nonetheless, the Commission believes that individual and unforeseeable circumstances may warrant mitigating action and that state commissions are the proper governmental bodies to assess the economic and equity issues involved.

The Commission believes it is desirable to make such authority available for those states which can or wish to make use of such authority. Some states indicated by written comments and oral argument that they may be legally precluded from making such adjustments. Since Congressional review of this rule implies quasi-legislative status, states may have sufficient authority to prevail against a challenge to this mitigating action as violative of state non-discriminatory laws.

D. **Market Ordering.**

1. **The threat of price instability upon deregulation.**

The ceiling price of new natural gas will be $2.90 per Mcf, or the energy equivalent of $18.00 per barrel oil, (in constant 1980 dollars) at year-end 1984. One day later, price controls on that gas will cease to apply.

The exact price to which new natural gas will rise upon deregulation will depend upon market factors that cannot be fully anticipated at this time. On balance, the record developed in this proceeding indicates that the wellhead price of deregulated gas purchased by interstate pipelines in 1985 is likely to rise significantly as a result of two influences. One influence is the overall condition of natural gas markets; if demand exceeds supply there will be upward pressure on prices. The other influence on new gas prices will be the continued regulation of "old" natural gas at prices below its commodity value. This gas provides an opportunity for pipeline and distribution companies to "roll-in" or average this low-cost gas with high-cost gas and still have a marketable product. The result could be considerable market instability.

Most comments that addressed the pricing issue predicted that after deregulation the average delivered price of gas will move, over time, toward a price equivalent to the delivered price of fuel oil. If so, the dramatic run up in fuel oil prices that has occurred since the NGPA was enacted in 1978 could cause the wellhead price of new natural gas to jump significantly when deregulated on January 1, 1985. Some observers base their assessment of where the wellhead price of new gas will go in 1985 by assuming that it will simply track the price of "high cost" gas that is already deregulated. Some of this "high cost" gas is being purchased today at prices equal to or greater than the equivalent price of No. 2 distillate oil.

The current delivered price of No. 2 fuel oil is about $32.00 per barrel, or $5.50 per MMBtu. Assuming 2 percent per year real growth in the price of No. 2 fuel oil between now and 1985, the price would be in the $6.00 per MMBtu range. If high cost gas prices remain tied to No. 2 fuel oil prices and set the market price for all deregulated gas, then the price of new natural gas will double upon deregulation. Pipelines may be able to pay prices equivalent to No. 2 oil for deregulated new gas in 1985 and yet maintain overall marketability due to their ability to blend this relatively high priced block of gas with lower priced "old" gas.

Natural gas markets can currently support prices in the $6.00 per MMBtu range for limited amounts of "high cost" deregulated gas, but there is reason to question whether such prices can be maintained over the long run. One strong conclusion emerging from the Commission's work on Phases I and II of incremental pricing is that there is a substantial block of demand in the industrial and electric utility sectors that has dual firing (natural gas and fuel oil) capability. Most industrial and electric utility boiler fuel use, and a considerable portion of industrial process use, will switch from gas to oil if relative prices favor such switching. Twenty to twenty-five percent of interstate demand is encompassed by users with dual firing capability. Most of these users have the current or technical capability to burn residual fuel oil, and would presumably switch away from gas well before delivered gas prices approach equivalence with No. 2 fuel oil prices.

Confronted with the prospect of losing so significant a portion of their market, interstate pipelines will attempt to keep the average delivered cost of gas competitive with residual fuel oil prices. As volumes of old gas decline, and therefore the amount of subsidization of new gas by old gas diminishes, the wellhead price of deregulated gas will eventually be below the level of equivalent distillate oil prices. If gas supplies are ample and if fuel oil prices remain as depressed as they are at present, it is possible that any "spike" or surge in deregulated wellhead gas prices in excess of long-run equilibrium levels will be both small and short-lived. Currently, industrial delivered gas prices are in the general range of delivered residual oil prices in most regions of the country.

Important gauges of gas market conditions as 1985 approaches are (1) whether the price of deregulated "high cost" gas is falling in relation to delivered fuel oil prices, and (2) whether other categories of gas, particularly new gas, are selling below the applicable maximum lawful ceilings set by Title I. If high cost gas prices remain at or above No. 2 fuel oil price levels in 1984, and if Title I ceiling prices are acting as binding constraints on wellhead prices, then these indicators would suggest that some significant price jump can be expected to occur January 1, 1985.

The pace at which prices might rise in 1985 is also important. The issue turns in large measure on whether producers of gas to be deregulated in 1985 will have contractual authority to immediately collect market prices, or whether instead the pricing terms of contracts covering deregulated gas will hold the price of that gas to some lower level.

In response to questions posed by the Commission on this issue, various interstate pipelines, including the United Gas Pipe Line Company, indicated that all of the contracts now written for gas that will be subject to deregulation in 1985 contain so-called "most favored nation" clauses that are designed to go into effect on January 1, 1985, or whenever gas covered by the contract is deregulated. These clauses permit a producer (seller) to instantaneously adjust the price of its deregulated gas up to the highest prices being received by any producer in the same field or area in which the production subject to the contract is located. Should this type of clause be the rule rather than the exception with respect to gas subject to deregulation, then the upward surge of wellhead prices in 1985 could be very swift.

The Commission was unable to determine with certainty that the use of most favored producer clauses is the sole or predominant practice with respect to gas subject to deregulation. This question was directed to the Interstate Natural Gas Association of America (INGAA), which subsequently asked this question of its member pipelines. However, INGAA was unable to provide a generalized statement on pipeline contracting practices. 13/

2. Volumes subject to deregulation in 1985.

The amount of gas that will be subject to deregulation in 1985, and therefore the resulting overall impact of deregulation on delivered gas prices, is uncertain. Some comments, nevertheless, attempted to estimate the volume of gas subject to deregulation in 1985. The Department of Energy estimated that between 55 and 65 percent of flowing gas in 1985 will be deregulated. The American Gas Association estimated a somewhat smaller fraction -- 40 percent of flowing gas in 1985 -- being subject to deregulation. The Commission believes that these estimates are reasonable and provide a useful range for purposes of examining the effects on consumers of deregulation in 1985.

13/ I regret that we are not in a position to provide you with sufficient information which would warrant the formulation of a generalized statement as to the contracting practices of the interstate gas transmission industry as a whole with respect to this subject. We did undertake to obtain such information. However, the responses received do not provide a representative base, nor do they contain sufficient content to permit a meaningful comparison. In that regard, we found that certain members were very general in their response, and others declined to respond. (Letter from Lawrence V. Robertson, Jr., Vice President, General Counsel and Secretary of INGAA, to Commissioner George Hall, dated February 8, 1980).

If 40 percent of the flowing gas stream in 1985 is deregulated and moves up in price by roughly $3.00 from $2.90 per MMBtu to $6.00, then the average price impact on all flowing gas would be approximately $1.20 per Mcf in 1980 dollars. If more than 60 percent of all flowing gas in 1985 is deregulated and moves up by the same $3.00 increment, the average impact on all flowing gas would be closer to $2.00 per Mcf in 1980 dollars. Such changes would represent a 30 percent increase over anticipated residential rates that should be approximately $5.00 per Mcf (constant 1980 dollars) and a 40 percent real increase over industrial rates that will be in the $4.00 per Mcf range at year end 1984. 14/

The Department of Energy expressed strong concern that the impact of a price "spike" at the time of deregulation in 1985 might be even more pronounced on intrastate consumers than upon interstate customers. This larger impact may result because, although gas in the intrastate markets will be regulated at roughly the same level as prices in the interstate market through 1984, the amount of intrastate gas subject to deregulation in 1985 will be far greater. As much as 85 to 90 percent of all flowing gas in the intrastate market may be deregulated under the terms of Title I in 1985. The impact of deregulation on average delivered prices of natural gas in the intrastate market could therefore amount to $2.50 or more per Mcf.

14/ Based on 1984 retail rate estimates contained in comments submitted by DOE (Table III-5).

The DOE comment, in noting the larger economic impact of the price "spike" upon intrastate pipelines and their consumers, went on to explain that intrastate pipelines will be placed at a competitive disadvantage vis-a-vis interstate pipelines with respect to bidding for supplies of deregulated gas. The competitive disadvantage to intrastate bidders arises from their smaller endowment of lower-priced gas subject to continuing regulation. The larger endowment of lower priced gas enjoyed by interstate pipelines will permit them to more heavily subsidize purchases of new gas out of their old gas "discounts".

Whether there will be a price spike upon deregulation, and whether the spike will have a significant impact on the distribution of gas between the inter- and intrastate markets will depend to a considerable degree on whether demand and supply for natural gas are in balance in 1985. If demand for natural gas considerably exceeds supply, there is a greater incentive for interstate pipelines to bid the price of deregulated gas to levels above long run market clearing levels. The ability of interstate pipelines to bid higher than long run marginal prices for deregulated gas and yet maintain overall marketability of the gas stream by averaging its cost could result in higher prices being bid by interstate pipelines than intrastate consumers would be willing or able to pay. Should deregulated prices rise in the short run above intrastate market clearing levels, there is the potential for sudden redistribution of gas supplies between inter- and intrastate markets upon deregulation in 1985.

The Commission made a substantial attempt to assess the outlook for natural gas supply and demand in 1985 as a part of its deliberations in this proceeding. On the basis of comments received, the Commission must first emphasize the extreme uncertainty inherent in this inquiry. Natural gas markets have changed dramatically in recent years, and may well experience further change. Nonetheless, the body of comments suggests that the potential for market imbalance in 1985 is very real. Numerous gas supply experts pointed out that the current rate of natural gas production significantly exceeds current rates of reserve additions. Studies submitted for the record in this proceeding, including those by Edward Erickson and James T. Jensen, point to declining availability of conventional gas supplies over the mid-and long term. The concensus appears to be that conventional lower 48 production may decline from a 1978 level of 19 Tcf to 16-17 Tcf in 1985, and will continue to decline to 12-14 Tcf in 1990.

A decline in production is forecast despite the current and likely continuing upsurge in drilling activity in the United States. According to Erickson's analysis, the rate of drilling activity will have to increase by 15 percent per year in each year between now and 1985 to sustain current production rates of natural gas. The Commission observes that there were record levels of drilling and gas well completions this past year in response to the incentive prices for natural gas allowed under the NGPA. Approximately 12 percent more rotary rigs were active in 1979 than in 1978. A sustained 15 percent per year increase through 1985 may be achievable, but not without a production commitment of unprecedented magnitude and duration.

Further, the scheduled decontrol of crude oil by year-end 1981 has created a roughly $5.00 to $6.00 per MMBtu incentive for new crude oil exploration and production. The wellhead natural gas price schedules under the NGPA provide incentives roughly half of that level. The Commission therefore perceives a potential producer bias toward crude oil and away from natural gas during the next few years despite the positive incentives created by the Natural Gas Policy Act. These factors may make it increasingly difficult to maintain natural gas production levels over the next four to five years.

While the record in this proceeding suggests a decline in natural gas production over the next decade, the comments of many end users, as well as by the American Gas Association, whose members include a number of distribution companies, reflect a growing demand for natural gas. According to the American Gas Association, the "economic demand" for natural gas in 1985 will be 26 Tcf. Current consumption is about 19 Tcf. In light of the current and expected price differential between natural gas and oil products, demand for natural gas may well be increasing.

In summary, most commenters appear to be in agreement that natural gas markets may experience a substantial and potentially abrupt increase in delivered natural gas prices in 1985. The ability of our economic and political systems to withstand a sudden energy price "shock" of the dimension that might occur in 1985 will no doubt be a subject of further debate. James T. Jensen, in his comments, expressed the view that the transition is inevitable and that policies such as incremental pricing which are designed to moderate transitional difficulties may create more problems than they cure. The Commission views this as an issue that, in the instant proceeding, must be resolved by the Congress. But the record does tend to underscore and support the concern that the Congress had in 1978 over the possibility of a disorderly transition to deregulation in 1985.

3. The Inability of Title II to Achieve Market Ordering.

Despite the need to achieve an orderly transition from egulated to deregulated gas markets, the incremental pricing rogram as specified by Title II of the NGPA does not appear to enerate the type of demand restraint that Congress sought. his conclusion stems from two sets of considerations. The first et derives from the institutions and structure of the natural as industry. The second set of considerations stems primarily rom limitations within the statute itself.

a. Institutional Considerations.

With respect to institutional factors limiting the ability f incremental pricing to restrain pipeline bidding for deregu- ated gas, the Commission accepts the view expressed in many omments stating that industrial end users who have little or no pability to switch to alternative fuels (e.g., most feedstock d many process users) are in a relatively weak position to affect the prices that pipelines will pay for natural gas. Only by reducing substantially their takes, through curtailment of operations or plant closings, can they hope to have any significant influence on pipeline bidding operations. Some conservation may be achievable by users without fuel switching capability, but the record before the Commission suggests that the results of such conservation efforts are likely to be too gradual, indirect, and difficult to measure for these effects to have significant short term influence on pipeline gas purchasing decisions. In short, incremental pricing is designed to exploit the demand responsiveness of price-sensitive marginal industrial consumers of natural gas. Where an industrial customer does not have alternative fuel capability, his short-term price responsiveness will be inadequate to produce significant demand restraint.

A majority of comments filed in this proceeding suggest that many process uses of natural gas proposed to be made subject to the scope of the Phase II rule are not capable of using alternative fuels in the short run. The Commission is uncertain as to what portion of the volumes of use subject to the Phase II amendment do in fact have a present or near term capability to use an alternate fuel. The Commission believes that many process users of natural gas currently without alternative fuel capability will add such capability, particularly in the form of electricity, if such natural gas uses are made subject to incremental pricing. For example, comments by the Process Gas Consumers indicate that many natural gas process applications can and will be economically converted to electricity when the delivered cost of gas is more than one third the delivered cost of electricity, because end use efficiencies are greater in electric applications and the continued availability of electricity is more assured. As stated, however, the extent of present or projected alternative fuel capability for uses within the scope of the Phase II amendment is not discernible at this time.

A second institutional consideration perceived as limiting the ability of incremental pricing to accomplish pipeline bidding restraint lies in the attitudes of pipelines toward their customer markets. Several comments explained that pipelines take a relatively long term outlook when it comes to supply acquisition decisions. Pipelines are seldom deterred from acquiring high priced sources solely on the threat that such gas prices might presently make the gas unmarketable to industrial customers on a stand alone basis. Pipelines perceive that declining old gas volumes compel acquisition of additional supplies in order to maintain service to high priority markets and are unwilling to view the short-run threat of unmarketability to the most price sensitive customer as a deterrent to that acquisition. Stated alternatively, pipelines view industrial customers as marginal customers in the short run but view residential and high priority customers, whose demand for gas is far less price sensitive, as the marginal customers over the long run. It is unclear whether end use pricing policy that targets price increases onto the short run marginal customer can be expected to significantly affect pipeline purchasing practices that are dominated by long run supply maintenance considerations.

Still another institutional consideration reflected in the Commission's record in this proceeding is that many industrial users find it hard to believe that they can have any significant influence on the gas purchasing decisions of their interstate pipeline supplier. Many industrial users told the Commission they never talk directly to their interstate pipeline supplier. Instead, they direct any gas supply or price problems to their local distribution company supplier. These commenters do not expect to communicate directly with their interstate pipeline even in the face of rising prices upon deregulation. The comments of interstate pipelines, however, lead the Commission to believe that interstate pipelines are much more sensitive to and concerned about the status of their industrial customers, even industrial customers served indirectly through local distribution company suppliers, than is commonly recognized by the industrial customer.

A final institutional consideration raised in the comments received that may limit the ability of incremental pricing to achieve its market ordering objective is the role of the states in the overall program. As noted previously, a majority of states have raised the rates charged by local distribution companies to industrial customers up to or above the Federally determined alternative fuel price ceiling. This action is taken in order to capture the maximum price shielding benefit for high-priority customers within each state. However, a side effect of state level incremental pricing is that industrial users may perceive the state, rather than the interstate pipeline purchaser, as the cause (and cure) of high delivered gas prices. In effect, state level incremental pricing may remove any perceived reason for industrial customers to appeal to their pipeline to keep the price of gas within reasonable limits. Instead, industrial users may incorrectly perceive that their efforts would be more usefully directed at state ratemaking policy.

b. Statutory Considerations.

Even if the first set of considerations relating to the possible institutional limitations on the efficacy of Phase II can be overcome, there is a second set of considerations that leads the Commission to question the ability of Title II to achieve its market ordering purposes. These considerations stem from limitations and inconsistencies in the structure of Title II itself. It appears that Congress intended that the threat of industrial load loss create an incentive on pipelines to moderate their purchased gas costs. This threat is present, however, only if incremental pricing can take the delivered price of industrial gas sufficiently near or even above the price of fuel oil to induce fuel switching. But Title II and its legislative history also evidence a Congressional intent that incremental pricing not be responsible for any significant amount of industrial load loss.

Specifically, section 204 of the NGPA instructs that each user's incremental pricing surcharge is to be calculated in such a way as to bring each user's delivered natural gas price up to, but no higher than, the alternative fuel ceiling as determined by the Commission. Hence if the Commission sets an intentionally low price in order to avoid unintended fuel switching, the industrial user is also effectively held below its true alternative fuel cost.

Because the alternative fuel ceilings in section 204 operate as ceilings rather than floors on the price of delivered industrial natural gas, industrial users who reach their ceilings become indifferent to subsequent increases in wellhead prices of gas because the full increase is borne by exempt rather than incrementally priced users. By making the marginal industrial customer indifferent to further increases in the price of deregulated gas, the net consequence of the price ceilings imposed by the incremental pricing program in Title II may be to increase the likelihood of a price spike and disorderly natural gas markets after deregulation rather than facilitate an orderly transition. Pipelines would be left to make their bidding decisions solely on the basis of the ability of less-price sensitive high priority customers to bear the higher costs of deregulated gas.

Whether the foregoing "cap problem" imposed by Title II will cause deregulated markets to be more unstable than without incremental pricing depends primarily upon when industrial customers subject to incremental pricing reach their alternative fuel ceilings and whether the catch up stage 15/ has been completed by 1985.

During the catch up period, as industrial user MSAC's are declining to zero, increases in the average wellhead price of gas are borne totally by exempt users. When the catch up period is over, incrementally priced user surcharges vanish and the system reverts to rolled-in pricing. This means that if the system has completed the catch up period before 1985, then industrial users will not be actively capped by their alternative fuel ceilings and will therefore bear at least the rolled-in portion of deregulated gas prices.

Only during the catch up stage can the alternative Title II fuel price ceiling mechanism actually exacerbate market instability by temporarily insulating industrial users from wellhead prices. Rising wellhead prices during the catch up period are spilled over, and have the effect of raising base rates to incrementally priced users. But under section 204, these higher base rates are merely offset by reduced surcharges, so that the delivered price, inclusive of surcharge, is unaffected by changes in pipeline gas costs until the catch up period has been completed. Once the catch up stage is over, industrial rates are no longer held at the alternative fuel price ceiling.

The problem associated with the ceiling price aspects of the incremental pricing provisions of Title II appears to be particularly serious under state level incremental pricing. States may

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15/ See discussion of the three stages of incremental pricing in section III-B of this Order.

set their rates to incrementally priced industrial users at the Federally prescribed alternative fuel price ceiling. The problem that arises is that states will not have sufficient information to know when the "catch up" stage is over and rolled in pricing should be resumed. The net consequence is that states may keep industrial rates below the level that would prevail under rolled-in pricing.

Under incremental pricing administered at the interstate pipeline level, distributors will know when the catch-up period has ended and will know when they or their state regulatory agency should begin to set the price of gas to incrementally priced users at levels higher than the Federally determined alternative fuel price. But when states supersede the interstate pipeline incremental pricing program, they eliminate the process of displacing surcharges through increased base rates, so that the "signal" to revert to rolled-in pricing becomes garbled. It should be clear, therefore, that the cap, when imposed by state level incremental pricing, may constrain industrial prices to an even greater degree than under the Federal incremental pricing system or under rolled-in pricing. This protracted cap on industrial rates could have the effect of exacerbating the volatility of pipeline bids for deregulated gas while also magnifying the potentially disruptive impact of deregulation upon exempt users.

On the other hand, states may be able to reduce or eliminate the seriousness of the cap problem in Title II if they set the price of gas to industrial users at higher than Federally prescribed alternative fuel ceiling levels. Section 205 of the Act prevents states from setting industrial rates lower than the alternative fuel price ceiling but reserves the right of states to impose higher rates to incrementally priced users.

Another possible approach that the states may adopt in an effort to impose market discipline and stability during deregulation would be to deny local distribution companies full pass through of any natural gas costs that the state determines to be a consequence of interstate pipeline purchases at excessively high prices. During its hearings on the Phase II incremental pricing rules, the Commission was told that states in most instances have the legal authority to deny full pass through by their jurisdictional distribution companies of gas acquisition costs considered to be excessively high. It is far from clear, however, that the states would exercise such authority in even the most extreme circumstances following decontrol in 1985. The Commission further points out that it is in no way able, nor does it seek the authority, to compel states to take such action in 1985.

The Title II alternative fuel ceiling on incremental pricing surcharges is determined by the price of alternative fuel oil. The concern with market disorder, however, is directed to the possibility that the price of deregulated natural gas at the wellhead might rise to a level higher than oil-equivalent prices. By placing a ceiling on incremental pricing surcharges such that the industrial incrementally priced user's price cannot go above its alternative fuel oil price, the statute effectively deflects any excessively high portion of deregulated wellhead prices away from incrementally priced industrial users and onto exempt higher priority users. The motivation for this limitation is apparently the Congressional desire to avoid industrial load loss. The consequence, however, appears to conflict directly with the objective of demand restraint and market ordering insofar as incrementally priced users are shielded from the very disorder they are supposed to help cure.

Some form of end-use pricing system based not on oil prices but based instead on measures indigenous to the natural gas system would seem preferable to the oil-based ceiling in order to achieve the Congressional market ordering objective that, in part, led to enactment of Title II. At present, the Commission does not believe that its discretion to set appropriate alternative fuel ceiling prices is a sufficiently broad grant of authority to permit incrementally priced user surcharges to be based upon the performance of the gas market rather than upon prices of alternative fuel oil. The Commission will, however continue to explore this question as well as the related question of whether other discretionary aspects of Title II can be interpreted in a manner that would support achievement of Congress' market ordering objectives.

4. Further Study and Recommendations To The Congress.

The Commission believes that the appropriate course of action at this time, considering the uncertainty that exists as to the appropriate amount of market ordering that will need to be brought to bear in 1985, is to commit to further study of future market conditions. The Commission acknowledges and accepts the view of those who argue that incremental pricing is a complex program. The Commission in its efforts to bring order to a deregulated natural gas market might well produce greater disorder through improperly designed incremental pricing regulations. Even if the Commission were directed by the Congress to exercise broader discretion in its administration of Title II, it does not appear feasible or advisable to attempt to craft a program in 1980 that tries to produce optimal performance in 1985. For these reasons the Commission will continue to examine anticipated 1985 market conditions, and by year end 1983 will deliver to the Congress a report that delineates the overall condition of the gas market and any recommended administrative measures then perceived to be available to the Commission that could be directed toward achieving the appropriate amount of market ordering.

One such measure already under Commission consideration is a proposal to link incremental pricing alternative fuel price ceilings with industrial user curtailment priority. Under this approach each user, rather than this Commission, would determine its own alternative fuel price ceiling. To avoid what would otherwise be a strong incentive of a facility to understate its alternative fuel ceiling and thereby minimize or even avoid its incremental pricing surcharge, the approach would tie the industrial user's curtailment priority to its self-selected alternative fuel price ceiling. Simply stated, those users who nominate higher alternative fuel price ceilings would enjoy higher curtailment priority. The Commission has been interested in this concept and last summer issued a Notice of Inquiry and held an informal conference to receive comments. The Commission's continued strong interest in the approach stems from a desire to substitute market forces for regulatory programs governing both curtailment policy and incremental pricing administration that are of considerable administrative complexity and burden.

In addition to exploring administrative options that might help to cure the cap problem perceived to exist under Title II, the Commission will in its 1983 review also make appropriate legislation recommendations to the Congress to assure that the incremental pricing program does not conflict with its Congressionally stated purpose of easing the transition of natural gas markets to deregulation in 1985 and thereafter.

One specific area of inquiry relevant to Congress's market ordering goals arises from Section 306 of the Public Utility Regulatory Policies Act of 1978 (PURPA), which calls for a study of gas utility rate design proposals. The study is being conducted by the Department of Energy in consultation with this Commission. The Commission, largely on the basis of its work on the incremental pricing program, has come to believe that appropriate wholesale and end use rate design concepts could serve as instruments in preparing natural gas markets for deregulation. However, the Commission also notes, on the basis of the many years in which public attention has been actively directed to electric rate design initiatives, as well as the inherent complexity of gas-rate design, that there is relatively little prospect of a major change in gas retail rate policy and procedures before 1985. Nonetheless, gas retail rate design is the proper focus of increasing public scrutiny.

Traditionally, the fundamental issue in natural gas rate design has involved allocation of pipeline fixed costs to each of the various customer classes being served. This set of issues was the appropriate focus of inquiry during an era in which transportation and distribution costs amounted to 75 percent or more of the delivered price of gas, and the expansion of an efficient natural gas delivery system was of greatest priority. But in recent years the commodity (purchased gas) component of gas rates has risen to the point where it represents more than half the delivered cost of gas. 16/ In the future, the commodity component is expected to dominate delivered costs to an even greater extent.

The gas rate design study conducted as directed by PURPA as well as follow-on studies will, it is hoped, lead to substantial examination of the role that gas rate design can play in encouraging stable, orderly and efficient natural gas markets.

16/ In 1960 the average wellhead price of gas was 14 cents per Mcf, while the average delivered price to end users was 60 cents. At year-end 1979, the figures were $1.35 per Mcf at the wellhead versus $2.52 per Mcf delivered.

E. Residential and Other High Priority Price Shielding. The second principal objective intended by the Congress to be achieved through incremental pricing is the partial shielding of residential and other high priority users from the increasing wellhead prices for natural gas allowed by Title I of the NGPA.

Incremental pricing will achieve a measure of price shielding of exempt users by channelling a portion of increased wellhead gas prices to industrial (non-exempt) users of natural gas. To the extent that incrementally priced users absorb higher gas prices, the amount of total costs remaining to be recovered from exempt users will be reduced. Thus, the costs of gas to residential and other exempt gas users will be somewhat lower than if no incremental pricing program were in effect.

As noted previously, the Commission believes that the objective of price shielding can be best advanced by a Phase II rule covering as broad a class of non-exempt users as possible. The Commission also believes, however, that the measure and speed by which price shielding occurs must be tempered by economic and equity considerations. Specifically, the alternative fuel price ceiling should not be set so high as to drive industrial users off of natural gas, thereby creating disarray in both the natural gas market and the economy as a whole. To do so would be inimical to the price shielding objective, because large losses of industrial load would reduce the total amount of incremental gas acquisition costs absorbed by the class of incrementally priced users.

In summary, the Commission concludes that a Phase II rule of broad scope, combined with a moderate alternative fuel price ceiling, is the central feature of a realistic Phase II rule capable of achieving the type of price shielding anticipated by the Congress. According to the Commission's projections in the follwing section addressing economic impacts, the Phase II rule proposed here is structured with the objective of avoiding economic disruption in the industrial sector and loss of large volumes of non-exempt uses, while benefiting exempt users approximately $.14 per Mcf. This potential benefit translates for the average household using natural gas for heating and cooking purposes to about $18 per year.

The Commission perceives this measure of potential savings to exempt users as the present optimum level of price shielding under an administratively workable and economically reasonable Phase II rule, balancing the need to provide some increase in incremental cost absorption by non-boiler fuel industrial users and the need to avoid industrial disruption.

The Commission would submit that this single tier Phase II rule will provide as much price shielding as the Congress originally expected to achieve by Title II because prices of petroleum products have increased dramatically since the NGPA was enacted. The price of No. 6 residual oil at year-end 1980 is likely to be higher than the price of distillate oil in 1978. Because the amount of price shielding is a direct function of the alternative fuel price, whatever benefits accrue to high priority customers from the Commission's decision to use the single No. 6 fuel oil tier for Phase II should be comparable in magnitude to what the Congress had in mind when the NGPA was passed in 1978. The Commission is mindful that the Congress, by means of the statutory review it provided for itself, reserved for Congressional judgment the decision as to whether this amount of price shielding warrants implementation of an expanded incremental pricing program.

In concluding that a Phase II expansion of the incremental pricing program can advance the price shielding objective, the Commission is cognizant of and has studied carefully the substantial body of comments filed in this proceeding that argued against the achievability of this objective. The most frequently raised objection to the Commission's attempting to implement the Congressional directive to provide enhanced price shielding is the argument that a Phase II rule would ultimately harm exempt users rather than help them. These comments contended that a Phase II rule, especially a broad rule, will actually increase the price of gas to exempt users. It was argued that the Phase II rule will result in sufficient load loss among non-exempt users such that a far greater share of fixed transmission and distribution costs will have to be borne by exempt users. These increased costs would include expenses for additional peak shaving and storage facilities that would be necessay if a supplier's interruptible industrial loads were lost. Higher delivered gas prices would also result from increased costs of financing due to service instability confronting pipelines and distributors.

The Columbia Gas Distribution Company, Natural Gas Pipeline Company of America and the AGA, among others, making comments embodying this theme asserted that any load loss is incompatible with the Commission's mandate under Title II of the NGPA.

The Commission does not accept the view that any load loss would be incompatible with either the letter or the intent of Title II. Under section 204(e), the Commission is granted the authority, but is not required, to lower the alternative fuel price ceiling below the price of No. 2 fuel oil. The first important point, therefore, is that Congress recognized that too high an alternative fuel price ceiling could have an adverse impact on exempt customers, which led it to provide a mechanism allowing the Commission to reduce the ceiling price. But the Congress clearly did not compel the Commission to reduce alternative fuel price ceiling levels in every instance in order to avoid adverse impacts on high priority users.

The Commission seeks to exercise its discretion to set the alternative fuel price ceiling low enough to avoid increased rates to residential, small commercial and other high priority users. But this does not, in the Commission's view, mean that there must be absolutely no industrial load loss. In fact, some degree of load loss may be consistent with the objective of maximizing incremental pricing benefits to high priority users. As the Department of Energy explained in its comments, the Commission's approach to determining an appropriate alternative fuel price ceiling should weigh the amount of absorption capability (MSAC's) of remaining non-exempt users against the reduction in fixed charge recovery from users who switch from gas to alternative fuel. Only if the Commission sets an alternative fuel price ceiling so high that the loss in fixed charge recovery exceeds total remaining MSAC's would high priority customers be disadvantaged by incremental pricing.

Furthermore, as discussed more fully in the previous section dealing with market ordering, the Commission believes that the Congress must have intended at least some load loss to result from Title II. Absent a real threat of industrial load loss attributable to incremental pricing, the program cannot be expected to motivate pipelines to restrain their wellhead bidding decisions. Given the program's market ordering purpose, some industrial load loss would be compatible with Title II if the resulting reduction in deregulated gas acquisition costs more than offsets the increased allocation of fixed costs to high priority customers. Such a result would occur if the reduction in industrial demand for gas so reduces bidding pressures on deregulated gas that the average unit cost of gas (at the wellhead) decreases by more than the amount by which the average unit cost of transmission and distribution is increased. In short, the logic of Title II is that some load loss could, and under appropriate circumstances would, actually benefit high-priority customers. Therefore, the argument that the Commission must assure against any load loss is not persuasive.

Even if some load loss is permissible under incremental pricing, Phase II, if adopted, should not cause any significant load loss because the alternative fuel price ceiling will be set at the No. 6 high sulphur oil price level. The comment of E. I. DuPont de Nemours & Company (DuPont) also pointed out that any increase in the price of gas to exempt users that could conceivably occur as a result of industrial load loss would be modest.

Another major theme expressed by TRW, Incorporated, the Proctor and Gamble Company and many other industrial users commenting in this proceeding is that incremental pricing will result in "artificially" low delivered gas prices to residential and other exempt users, thereby eroding their incentive to conserve. These commenters argued that distorting energy price signals cannot be justified, and that no Phase II expansion should be put into effect because it would only magnify those distortions. Industrial users such as the Republic Steel Corporation considered this result particularly unfair, because they contended that they have already achieved greater conservation than residential or other high priority users. If the remaining conservation potential is greater among these latter users, then industrial users believed that the nation's energy goals would be ill served by shielding them from the true cost of the energy. Further, DuPont expressed the fear that without more conservation among exempt users, high priority demand will increase to the extent of bringing earlier curtailment of low priority users.

The Commission accepts the need to provide proper price signals to gas users. However, the Commission notes that as long as gas prices are cost-based and reflect average ("rolled-in") historical costs of old contracts with low prices, the prices yielded by such a regulatory practice will not reflect the commodity value of the gas and, therefore, the price signals will not reflect the "true" value of the gas to society. More particularly, the Congress has explicitly made the fundamental social policy decision to redesign the system by which gas costs, in the past, have been allocated among user classes. The Commission regards the explicit reallocation system embodied in Title II as reflecting a Congressional determination going in the other direction -- that rolled-in pricing produces unacceptable price shielding of industrial customers.

Furthermore, the Commission believes that the amount of price shielding afforded to high priority users by this Phase II rule will not be of such a magnitude as to mislead them into thinking that their natural gas costs will not rise significantly and steadily over the coming years. Even if the disputable claim that industrial users have less remaining conservation potential than high priority users is correct, the Commission does not accept the argument that price distortions of the magnitude associated with adoption of this Phase II rule would create any significant disincentive to overall conservation of natural gas.

It is also significant that even though Phase II will raise industrial gas prices and reduce the amount of increases borne by residential and high-priority users, the delivered price of gas to incrementally priced users is projected to remain less than the price to residential customers in every state.

The average delivered cost of gas to residential customers served by interstate pipelines is approximately $3.70 per MMBtu. The average industrial rate (exclusive of any incremental pricing surcharge) is about $2.65 per MMBtu. Based on current high sulfur No. 6 oil prices, incremental pricing surcharges are about 25 cents, so the average cost of gas to incrementally priced users is $2.90 per MMBtu. The cost of gas to Phase II users will, therefore, be below the price to residential users. Arguments that incremental pricing in general and Phase II in particular will dramatically distort price signals to various customer classes might be valid if No. 2 fuel oil had been used as an alternative fuel ceiling. But in light of the Commission's decision to use a single tier high sulfur No. 6 fuel oil ceiling, these arguments take on diminished significance.

The Commission also calls attention to several comments that correctly characterized incremental pricing under Title II as a purely transitional device. The program initially "loads" gas costs onto industrial users and thereby "shields" other users. But the loading stops when industrial users reach their alternative fuel price ceilings. Subsequent increases in gas costs "spill over" onto high priority and exempt users until they eventually catch up to the price path they would have been on without incremental pricing. While the Commission believes that the amount of price distortion arising from Phase II is not sufficient to conflict with national conservation goals, it also attaches additional significance to the fact that any such distortion will be only temporary. It is interesting to note that while some commenters argued that incremental pricing will cause such dramatic distortions in the energy marketplace that it should not be expanded, other commenters argued that the program is so transitory that its administrative burden is unwarranted.

The Commission concludes that at least on the basis of current conditions, there is no basis for a judgment that Title II in general or Phase II in particular will so seriously distort natural gas price signals as to frustrate progress toward more efficient nationwide use of energy resources. The fact that some, but not all, consumers may be paying prices for gas that reflect its true commodity cost, and thereby receive the proper signals, is at least an improvement over the present situation even if it does not go as far as might be required to effect an overall pricing strategy to promote conservation.

A great many comments called attention to potential inequities seen as resulting from successful price shielding of high priority gas users. These comments suggested that the ultimate cost of subsidizing exempt gas users will be borne by non-gas homeowners who instead use more expensive fuel oil, electricity, propane, or other sources. The Process Gas Consumers argued, for example, that "incremental pricing affords these latter homeowners no subsidy on their energy bills; yet, incremental gas pricing will force them to pay higher prices for virtually all consumer goods in order to widen the gap between their own energy bills and those of gas consuming residences."

The Mobay Chemical Corporation suggested that it is inequitable to exempt high priority users who have significant potential to conserve and not exempt some industrial users (e.g., feedstock gas users) who, by definition, have no capacity to conserve. It troubled the Petrochemical Energy Group and the Goodyear Tire and Rubber Company, among others, for some high priority industrial uses (e.g., feedstock and other non-boiler uses) to subsidize certain low priority exempt uses (e.g., cogeneration facilities and electric generation).

Title II will, by design, produce results that are more favorable to some classes of users. But the Congress apparently weighed these inequities against the advantages of an incentive wellhead pricing system in Title I of the NGPA, and, on balance, concluded that one was necessary to accommodate the other. It thus falls upon the Commission to exercise appropriately its discretion in crafting a Phase II program that will advance the objectives of the NGPA while avoiding unacceptable and non-mandated inequities arising from the program.

The Commission believes that it has properly responded to the equity concerns raised in comments. The choice of a single No. 6 fuel oil tier rather than the originally proposed three-tier alternative fuel price ceiling system and the first 300 Mcf per day exemption of Phase II uses will greatly reduce the amount of income redistribution resulting from Phase II. Phases I and II together are expected to reallocate no more than about $1.3 billion per year between non-exempt and exempt users.

Comments by the American Gas Association and Process Gas Consumers asserting that Phase II will induce significant economic disruption and increased overall inflation are premised on dollar flows at least six or seven times greater than will result from the Commission's single tier approach. As noted in the following section on the economic effects of Phase II, the President's Council on Wage and Price Stability is persuaded that even the Commission's original Phase II proposal "is unlikely to increase inflation significantly."

The Commission's decision to adopt both the single tier approach and an exemption for the first 300 Mcf per day of Phase II uses stem from recognized need to mitigate any economic or equity disruptions that might have resulted from the Phase II rule as originally proposed.

One specific inequity, identified by Goodyear and others, is that under a three tier system, Phase II users without No. 6 fuel oil capability would pay gas prices equivalent to No. 2 distillate oil prices. Because of the large difference between the prices of No. 2 and No. 6 fuel oil, high priority industrial users without No. 6 capability would contribute far more to the price shielding of exempt users than would lower priority boiler and other industrial users who in general have, or can relatively easily install, No. 6 capability. In short, a disproportionate share of the subsidy to exempt high priority users would be coming from high priority industrial users if Phase II were to use the three-tier ceiling price system originally proposed. This inequitable result will now be avoided because the Commission will set the alternative fuel price ceiling applicable to Phase II uses at the lowest of the three tiers applicable to Phase I uses.

The Commission believes that the Phase II system contained in this rule for submission to Congress, represents the best balancing of the price shielding objective and the need to avoid disruptive and inequitable impacts which ultimately would work against the best interests of the high priority consumers whom Title II was intended to serve. However, as pointed out in several comments, incremental pricing under Title II is a "blunt instrument" for achieving the socio-economic goals Congress sought to accomplish via price shielding.

Title II provides some price sheltering to all exempt users, regardless of their economic need for this or any other type of subsidy. Phases I and II combined will cause about 25 percent of interstate gas to be incrementally priced. Fully 75 percent of all interstate consumption will share the benefits of surcharges paid by industrial users. Thus, a $.60 per MMBtu surcharge paid by incrementally priced users translates into only a $.20 per MMBtu benefit to exempt users. More significant relief to those unable to pay rising gas costs would be better achieved through other mechanisms such as a targeted incremental pricing program or direct energy cost assistance. However, such mechanisms are beyond the scope of Title II, and therefore not a proper subject of this Commission's actions. The Commission nonetheless notes these views and calls them to the attention of the Congress.

V. Economic Effects of Phase II.

Of major concern to the Commission and a majority of commenters is the need for the Phase II rule to be crafted in a manner that avoids imposing excessive economic stress on individual firms or on the overall economy. The Commission believes that the Phase II rule described herein is adequately responsive to those concerns.

The following discussion assesses the direct cost impact of the Phase II rule on those industries that are significant users of natural gas subject to the rule. Using state-by-state industrial gas consumption profiles, the potential impact on each State is also evaluated. Following the section on direct cost impacts is a discussion of the macroeconomic impacts of the Phase II rule.

A. Direct Cost Impact. Many commenters stated that the proposed three-tier program would result in extremely large increases in energy costs. Industrial users without alternative fuel capability predicted that their gas prices would increase on the order of 200 to 300 percent. The impact of such a price increase was depicted as severe. Many firms affected by Phase II compete with other firms not subject to incremental pricing -- either intrastate gas users or foreign companies. Faced with such competition, a company would be constrained in the passthrough of increased costs to the consumer. Unable to fully recover increased costs, industries would be forced to absorb the costs through reduced profits. A number of commenters stated that plant shutdowns might result from the proposed three-tier incremental pricing program.

In the final Phase II rule, the Commission has adopted two major changes from its proposed Phase II rule that will significantly mitigate any economic damage arising from the program.

The first change is the decision to use a single tier alternative fuel ceiling approach. With the originally proposed No. 2 fuel oil ceiling price, non-exempt gas users would be faced with surcharges of as much as $3.00 per MMBtu. The Commission's decision to apply a single ceiling price based upon high sulfur No. 6 oil will lead to a much lower average surcharge. At present, depressed market conditions for residual oil imply little or no surcharge. Residual oil prices are below average industrial gas rates in some regions, and are only about 25 cents above gas rates in most localities. Residual oil prices are not expected to remain depressed indefinitely, however. Towards the end of 1980, residual oil prices are expected to recover to a level of about $0.60 per MMBtu above the average industrial gas rate. So the Commission's single tier decision has cut the surcharge impacts on many Phase II users by a factor of five.

Furthermore, due to the second major change adopted by the Commission, this much lower surcharge of 60 cents will be paid only on volumes purchased in excess of 300 Mcf per day. This approach to the small use exemption will give every facility an exemption for a fraction of its total gas use, which will effectively lower the average price increase to Phase II users. The analysis contained in Appendix B estimates the effect of this exemption. The results of that analysis suggest that while the impact of the small use exemption on any particular non-exempt user will depend on the user's size, an aggregate of about 20 percent of the gas that would otherwise be subject to surcharge will be exempted by the small use exemption approach taken by the Commission. As a rule of thumb, an average user's first-year surcharge will be reduced from 60 cents to slightly less than 50 cents per Mcf. The effects of the agricultural use exemption are also addressed in Appendix B.

When all the various categories of manufacturing are summed, the total estimated interstate gas subject to incremental pricing under Phase II is as follows:

SIC	Industry	Non-Exempt Gas, Mcf
28	Chemicals	118,817,803
29	Petroleum	155,511,318
32	Stone, Clay & Glass	250,966,173
33	Primary Metals	314,283,660
22	Textiles	13,050,650
26	Pulp & Paper	2,221,332
--	Other Manufacturing	308,314,412
	Total	1,163,165,348

Assuming that all gas subject to Phase II were surcharged at $0.60 per Mcf, the nationwide aggregate surcharge would amount to $698 million per year. This figure represents a high value, not likely to be soon attained due to presently depressed residual oil prices. This aggregate cost estimate might be considered reflective of calendar year 1981, assuming that residual oil prices rise by year-end 1980 to levels experienced in recent months. Table 3 summarizes by industry and by State the effect of an assumed $.60 per Mcf surcharge on Phase II uses. The volume of exempt gas over which the surcharge dollars will be spread to achieve a price reduction will, of course, differ substantially among pipelines and among States. Ignoring such variations, a rough measure of aggregate Phase II impact can be gained by noting that the aggregate surcharge would be spread over approximately 9 Tcf of interstate gas consumption for exempt uses. The result is a price reduction of 7.75 cents per Mcf for these exempt volumes. Thus, a residential customer consuming 130 Mcf per year might save about $10 per year as a result of Phase II. This is in addition to an approximately $8.00 per year savings under the Phase I program if average surcharges equal $0.60 per Mcf.

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Table 3

AGGREGATE PHASE II SURCHARGES (thousands of $)
Includes Agricultural and Small Use Exemptions

	SIC-28 Chemicals	SIC-29 Petroleum	SIC-32 Stone, Clay & Glass	SIC-33 Primary Metals	All Other Manufacturing	SIC-22 & 26 Textiles and Pulp & Paper Non-Exempt	TOTAL
Alabama	1,646	730	3,854	8,709	4,516	819	20,274
Arizona	125	---	900	6,513	583	1	8,122
Arkansas	2,049	1,372	3,886	7,930	1,626	253	17,116
California	2,185	23,902	15,328	4,016	7,353	380	53,164
Colorado	35	397	1,882	2,258	2,012	2	6,586
Connecticut	---	---	---	135	731	---	866
Delaware	61	75	---	86	241	---	463
Florida	1,833	1,337	5,319	14	1,295	681	10,479
Georgia	1,691	176	9,810	93	2.407	2,569	16,746
Idaho	700	---	27	---	---	38	765
Illinois	3,552	2,940	10,550	18,607	16,150	133	51,932
Indiana	698	640	5,220	25,467	7,495	8	39,528
Iowa	2,795	---	2,965	1,309	3,069	8	10,146
Kansas	2,734	18,382	7,639	10	2,769	6	31,540
Kentucky	167	968	1,217	2,808	2,261	366	7,787
Louisiana	35,449	26,593	2,941	4,582	8,319	112	77,996
Maryland	250	---	1,544	2,573	1,155	3	5,525
Massachusetts	10	2	666	---	1,570	71	2,319
Michigan	1,504	1,031	4,069	9,302	38,314	147	54,367
Minnesota	18	260	618	6,909	750	26	8,581
Mississippi	721	624	2,252	16	2,615	123	6,351
Missouri	833	519	3,618	209	5,225	3	10,407
Montana	17	551	970	1,714	256	22	3,530
Nebraska	1,648	---	934	36	417	---	3,035
Nevada	142	---	951	34	41	---	1,168
New Hampshire	---	---	---	---	---	19	19
New Jersey	214	10	5,741	344	1,623	75	8,007
New York	483	---	3,455	3,501	7,195	95	14,729
North Carolina	391	---	1,930	83	430	711	3,545
North Dakota	---	37	7	---	---	---	44

(continued on next page)

$0.60/Mcf
Unit Surcharge

Table 3

AGGREGATE PHASE II SURCHARGES (thousands of $)
Includes Agricultural and Small Use Exemptions

	SIC-28 Chemicals	SIC-29 Petroleum	SIC-32 Stone, Clay & Glass	SIC-33 Primary Metals	All Other Manufacturing	SIC-22 & 26 Textiles and Pulp & Paper Non-Exempt	TOTAL*
Ohio	2,574	1,790	15,988	29,110	14,174	141	63,777
Oregon	303	181	461	901	2,561	71	4,478
Pennsylvania	53	7,305	13,717	32,621	14,537	101	68,334
Rhode Island	---	---	515	22	---	25	562
South Carolina	105	---	6,492	1,591	2,732	1,423	12,343
South Dakota	---	---	619	---	40	---	659
Tennessee	2,722	106	4,610	1,169	3,010	229	11,846
Utah	316	863	1,004	4,384	347	---	6,914
Vermont	---	---	---	---	160	4	164
Virginia	709	---	860	176	983	308	3,036
Washington	400	1,683	40	1,928	254	69	4,374
West Virginia	1,372	135	6,665	2,388	523	---	11,083
Wisconsin	39	35	1,094	999	7,301	120	9,588
Wyoming	748	664	224	---	---	1	1,637
TOTAL	71,292	93,388	150,582	182,547	167,040	9,163	674,726

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* Total reflects elimination of several large industrial facilities identified as using intrastate gas..

B. Macroeconomic Effects of Phase II. A large number of commenters have alleged that incremental pricing in general, and Phase II in particular, will be inflationary. The basis for this allegation is that incrementally priced industrial customers will simply raise the prices of their products to offset their increased energy costs. As cost increases are passed through the economy, it is argued that the aggregate impact is amplified through operation of a multiplier effect. The consumer, it is argued, will pay in the long run for such cost increases associated with incremental pricing.

At the forefront of the inflation debate has been a study performed for the AGA by Wharton Econometric Forecasting Associates. The Wharton econometric model has been run a number of times under different assumptions concerning Phase II. The initial run compared the effects of Phase II to a base case of Phase I only. In this analysis, Phase II was expected to bring 90 percent of all interstate industrial natural gas under incremental pricing. The Wharton analysis also assumed a ceiling price based on No. 2 oil, with no downward adjustments, for all Phase II users. Finally, the model incorporated a modified passthrough mechanism that allocated spillover from the surcharge account to all users, thus pushing non-exempt users above their alternative fuel price ceiling and frequently off the gas system. Given such a set of assumptions, it is not surprising that the AGA/Wharton study finds serious adverse impacts attributable to Phase II. Inflation and unemployment rates were predicted to worsen significantly. But this study cannot be considered a useful assessment of the probable effects of the final rule. The model was rerun with a three-tier price ceiling scenario as part of AGA's final submission in this docket. Even this revised assumption considerably overstates the direct cost impact of Phase II because the Commission's final rule sets a uniform ceiling based on residual oil prices for Phase II users.

Notwithstanding the accuracy of these specific input assumptions, other commenters have voiced concerns with the applicability of large scale macroeconomic models for analysis of the effects of a program such as incremental pricing. The Office of Policy and Evaluation of the Department of Energy filed comments which disputed many of the AGA assertions. The DOE analysis maintains that many industrial firms are constrained by competitive pressures and cannot fully pass along increased costs. Moreover, other inputs to industrial production such as exempt gas volumes and electricity generated from gas will benefit from incremental pricing. The commercial sector, a major component of the nation's economy, benefits directly from incremental pricing. DOE projected that if relatively little load loss occurs the net inflationary effect of incremental pricing will be small and possibly negative. However, the DOE submission also indicates that some inflationary impact could result if substantial load loss occurs.

Perhaps more important for purposes of assessing aggregate inflationary pressures arising from Phase II is the total impact in industrial fuel use patterns and pipeline load factors as a result of Phase II. The DOE comments maintain that loss of an individual gas customer to oil is not inflationary per se, and may have little or no inflationary impact if the gas is used by other customers. As long as some users are being curtailed, no aggregate load loss, and therefore no increase in gas delivery costs, will result from Phase II.

As a further step in their submission, DOE performed a macroeconomic analysis of Phase II similar to that performed by AGA. Stressing their contention that macroeconomic models are ill-suited for analyzing the impact of price changes of a single commodity, DOE ran a different model, Data Resources, Inc. (DRI), with the same set of input assumptions as AGA. The results of the two models are strikingly different. The DRI model projects a rate of inflation only slightly higher than under rolled-in pricing until 1985, at which point there would be a slight reduction in the rate of inflation. 17/ By 1990, the model actually predicts somewhat less inflation overall as compared to a rolled-in pricing base case. Another run was made to reflect a scenario without significant load loss; the result was essentially the same.

DOE concludes their comments with a critical look at the AGA/Wharton analysis. The direct costs to industry, assuming AGA's estimate of load loss, would amount to $29 billion in 1990.

17/ Inflation as measured by the GNP implicit price deflator. Measured by the Consumer Price Index (CPI), inflation is lower throughout the period in the incremental pricing case

Costs to other sectors of the economy, such as residential and commercial, decline by $16 billion in the same year when compared to rolled-in pricing. The net effect is a $13 billion price increase, in 1990 dollars. This direct price increase is compared by DOE to the tremendous $431 billion increase in inflation projected by the Wharton macroeconomic model. The DOE analysts express doubt that the implicit multiplier of 33, reflecting the assumption that $1 of direct cost increase to industry results in $33 of increased cost to final consumers, could possibly be correct.

The Council on Wage and Price Stability also filed comments in this docket. The Council's submission contains a detailed record of meetings with AGA and DOE technical staff. The record reveals a rejoinder to the DOE analysis submitted to the Council by Wharton. Yet another document submitted by DOE critically examines this rejoinder and questions the validity of its conclusions. This DOE submission provides further comment on the validity of using large-scale macroeconomic forecasting models to analyze the impacts of Phase II. In short, DOE analysts do not believe that any such model currently available is sufficiently detailed and appropriately structured for the task.

The Council notes the sharp disagreement concerning the inflation issue, but nevertheless indicates a belief that the short-term effects of Phase II should be either negligible or anti-inflationary. The Council is skeptical of the extreme inflationary impacts alleged by AGA/Wharton. Finally, the Council echoes DOE's contention that macroeconomic models are poorly suited to such uses as predicting the impact of price changes in a sub-sector of the economy.

In conclusion, the case for a large inflationary impact must be regarded as speculative, even assuming large surcharges to non-exempt users and significant load loss. The Commission notes that the surcharges in the 60 cent per Mcf range which result from the No. 6 oil price ceiling are far less than the $3.00 surcharges which might have resulted from use of a No. 2 oil based ceiling. The small use exemption will lower the effective average surcharge to about 50 cents per Mcf. Finally, the structure of the small use exemption will work to encourage conservation and ultimately may reduce inflation by pricing marginal use of gas closer to its replacement cost.

(Natural Gas Policy Act of 1978, Pub. L. 95-621, 92 Stat. 3350, 15 U.S.C. 3301, et seq.)

In consideration of the foregoing, if neither House of Congress passes a Resolution of Disapproval of the regulations transmitted to them in this Order within 30 days of Congressional review, as determined in accordance with section 507(b) of the NGPA, Part 282 of Subchapter I, Chapter I, Title 18, Code of Federal Regulations, is amended as set forth below, effective 90 days following the expiration of the 30-day review period, provided that §§ 282.215, 282.601 and 282.602 shall be effective July 1, 1980.

By Direction of the Commission.

(S E A L)

Secretary

1. The table of sections for Part 282 is amended to add a new § 282.208 entitled "Exemptions under section 502(c)" and a new § 282.215 entitled "Exemption affidavits."

2. Section 282.101 is amended to read as follows:

§ 282.101 Purpose.

The purpose of this part is to set forth incremental pricing rules in accordance with Title II of the Natural Gas Policy Act of 1978. The rules require that certain costs of acquiring natural gas be passed through as surcharges on sales of natural gas used as specified in the rules.

3. Section 282.102 is amended in paragraph (a) to read as follows:

§ 282.102 Applicability and effective date.

(a) Uses. (1) Natural gas used as boiler fuel in industrial boiler fuel facilities on and after January 1, 1980, shall be subject to incremental pricing under this part.

(2)(i) On and after [90 days following expiration of 30-day Congressional review period], natural gas consumed in uses other than as boiler fuel in industrial facilities shall be subject to incremental pricing under this part.

(ii) Shrinkage volumes removed as natural gas liquids or natural gas liquid products from a natural gas stream shall not be subject to incremental pricing under this part.

(b) Discretionary exemptions. Petitions for an exemption under authority of section 206(d) of the NGPA may be filed in the manner prescribed in § 282.206.

6. Section 282.203 is amended to read as follows:

§ 282.203 Exempt end-uses.

(a) Statutory exemptions. In accordance with the provisions of section 206 of the NGPA, natural gas used for the following purposes shall be exempt from incremental pricing under this part:

(1) all gas used for boiler fuel by an industrial boiler fuel facility which was:

(i) in existence on November 9, 1978; and

(ii) * * *

(2) * * *

(3) all gas used in a school, hospital, or similar institution;

(4) all gas used for the generation of electricity by an electric utility; and

(5) all gas used in a qualifying cogeneration facility.

(b) Partial exemption for non-boiler fuel use. That volume of natural gas consumed in uses other than as boiler fuel by an industrial facility which is not exempt from incremental pricing pursuant to paragraphs (a)(2) through (a)(5) and which is equal to or less than an average of 300 Mcf per day during any month shall be exempt from incremental pricing under this part.

7. Section 282.204 is deleted in its entirety.

8. Section 282.206 is amended in paragraph (a) by deleting the words "boiler fuel" from the term "industrial boiler fuel facility."

9. Section 282.207 is amended in paragraph (a) by deleting the words "boiler fuel" from the term "industrial boiler fuel facility."

10. Part 282 is amended to add a new section 282.208 to read as follows:

§ 282.208 Exemptions under section 502(c).

(a) General rule. The Commission may, under authority of section 502(c) of the NGPA, exempt any non-exempt industrial facility (or category thereof), in whole or in part, from any provision of this part.

(b) Procedures. The procedures set forth in § 1.41 shall apply to an application for an exemption in the nature of an adjustment as described in paragraph (a).

11. Part 282 is amended to add a new § 282.215 to read as follows:

§ 282.215 Exemption affidavits.

(a) General. This section establishes procedures by which owners or operators of industrial facilities may obtain an exemption for natural gas used for the purposes described in § 282.203.

(b) Obtaining an exemption. (1) In order to obtain a partial or total exemption from incremental pricing, an owner or operator of an industrial facility shall file an exemption affidavit, as described in paragraph (b)(3), signed and dated by a responsible official associated with the facility, under oath, with the Federal Energy Regulatory Commission, 825 North Capitol Street, N. E., Washington, D. C. 20426, and send a copy of the executed affidavit to the natural gas supplier serving the industrial facility.

(2) Commission to provide exemption affidavits. The Commission will provide exemption affidavits as described in paragraph (b)(3) to natural gas suppliers and to any other interested person upon request. Requests should be directed to the Division of Public Information, Federal Energy Regulatory Commission, Room 1000, 825 North Capitol Street, N. E., Washington, D. C. 20426.

(3) Contents of exemption affidavits. (i) The exemption affidavit will provide the owner or operator of an industrial facility with the opportunity to respond to a series of questions so that the owner or operator may establish, if appropriate, the basis for one or more of the exemptions set forth in § 282.203.

(ii) The exemption affidavit will indicate the record retention obligation which may be incurred by the customer under paragraph (b)(7).

(4) Effect of filing an exemption affidavit. If the owner or operator of an industrial facility files an executed affidavit in accordance with paragraph (b)(1), that volume of natural gas which is consumed in the facility for exempt uses shall be exempt from incremental pricing under this part, if determined in accordance with § 282.504(c)(2)(ii).

(5) Availability from natural gas suppliers. (i) Initial service. Not later than July 1, 1980, each natural gas supplier shall mail or otherwise supply an exemption affidavit, as described in paragraph (b)(3), to the owner or operator of each industrial facility on such natural gas supplier's system.

(ii) Response date. Natural gas suppliers which supply exemption affidavits under clause (i) shall request that executed affidavits be filed on or before August 1, 1980, in accordance with paragraph (b)(1).

(iii) Ongoing availability. After July 1, 1980, natural gas suppliers shall make exemption affidavits available at their principal place of business on an ongoing basis during regular business hours.

(6) Effective date of exemption. (i) If the owner or operator of an industrial facility files an exemption affidavit with the Commission and sends a copy to the facility's natural gas supplier in accordance with paragraph (b)(1) on or before [one day prior to day 90 days following expiration of 30-day Congressional review period], the facility shall be exempt from incremental pricing in accordance with this part as of [90 days following expiration of 30-day Congressional review period].

(ii) If the owner or operator of an industrial facility files an exemption affidavit with the Commission and sends a copy to the facility's natural gas supplier in accordance with paragraph (b)(1) on or after [same date as in clause (i) above], the facility shall be exempt from incremental pricing under this part as of the beginning of the first full month following the date the exemption affidavit is filed with the Commission and received by the facility's natural gas supplier.

(7) Record retention. If the owner or operator of an industrial facility obtains an exemption by filing an affidavit

in accordance with paragraph (b)(1), the owner or operator shall, for a period of at least three years from the date of filing the exemption affidavit, retain all records, documents or data which formed the bases of the responses on the affidavit.

(c) Public availability of exemption information.

(1) Executed exemption affidavits. Copies of executed exemption affidavits which are filed with the Commission shall be available for public inspection through the Division of Public Information, Federal Energy Regulatory Commission, Room 1000, 825 North Capitol Street, N. E., Washington, D. C. 20426.

(2) Lists of non-exempt facilities. (i) On or before November 1, 1980, each natural gas supplier shall file with the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, N. E., Washington, D. C. 20426, and with each state or local regulatory authority having appropriate jurisdiction over the supplier, a list of all industrial facilities served directly by the supplier which did not qualify for an exemption for their total use of natural gas as of [one day prior to day 90 days following expiration of 30-day Congressional review period].

(ii) On or before November 1 of each year after 1980, each natural gas supplier shall file with the agencies specified in clause (i) a revised list of all non-exempt industrial facilities served directly by the supplier. A revised list shall indicate all additions or revisions to or deletions from the prior year's list.

(iii) Lists of non-exempt industrial facilities filed in accordance with clause (i) or (ii) shall indicate the alternative fuel capability of each facility thereon, as established in accord with the provisions of § 282.403.

(iv) Lists of non-exempt facilities filed in accordance with clause (i) or (ii) shall be available for public inspection through the Division of Public Information, Federal Energy Regulatory Commission, Room 1000, 825 North Capitol Street, N. E., Washington, D. C 20426.

(d) Protests. (1) Any interested person may protest the exemption of an industrial facility from incremental pricing.

(2) The procedures set forth in § 1.10 shall govern the filing of such a protest, except that any person filing such a protest shall serve a copy of the protest on the affiant of the exemption affidavit.

(3) The affiant may file an answer to any protest. Such answer must be filed within 30 days of the service date of a protest. The affiant shall serve a copy of the answer on the party filing the protest.

12. Section 282.401 is amended by deleting the words "boiler fuel" and §§ 282.402 through 282.405 are amended by deleting the words "boiler fuel" wherever they appear in the phrase "industrial boiler fuel facility(ies)."

13. Section 282.501 is amended by deleting the words "boiler fuel" wherever they appear in the phrase "industrial boiler fuel facility(ies)" in paragraphs (c) and (c)(2) and by revising paragraphs (c)(3) and (d) to read as follows:

§ 282.501 General rule.

* * * * *

(c) * * *

(3) The maximum surcharge absorption capability of a non-exempt industrial facility for any calendar month shall be determined by utilizing the alternative fuel price ceiling(s) applicable to that calendar month and the meter reading(s) made during the meter reading period beginning on the 20th day of such month. If more than one meter reading is made in a meter reading period, a cumulative total of all meter readings made in such period shall be determined.

(d) Each month, in the case of interstate pipelines, the amount accumulated in the pipeline's unrecovered incremental gas costs account which cannot be recovered by way of incremental pricing surcharges shall be cleared from that account to account 805.2, Incremental Gas Cost Adjustments, in accordance with § 282.502.

14. Section 282.503 is amended by deleting the words "boiler fuel" from the term "industrial boiler fuel facilities" in paragraphs (a)(2)(ii) and (c) and by revising paragraph (b) to read as follows:

§ 282.503 PGA reduction.

* * * * *

(b) Projected MSAC of a non-exempt industrial facility.
(1) The projected MSAC of a non-exempt industrial facility for a coming PGA period shall be calculated by a natural gas supplier in accordance with the following formula, in which the symbol "^" indicates a projection:

$$\hat{M} = \frac{[(\hat{AB}_1 - \hat{RB}_1)\hat{VB}_1 + (\hat{AS}_1 - \hat{RS}_1)\hat{VS}_1]}{1 + \hat{T}_1} +$$

$$\frac{[(\hat{AB}_2 - \hat{RB}_2)\hat{VB}_2 + (\hat{AS}_2 - \hat{RS}_2)\hat{VS}_2]}{1 + \hat{T}_2} + \ldots$$

$$\frac{[\hat{AB}_n - \hat{RB}_n)\hat{VB}_n + (\hat{AS}_n - \hat{RS}_n)\hat{VS}_n]}{1 + \hat{T}_n}$$

where:

$\hat{M}$ = Projected MSAC of the non-exempt industrial facility.

$\hat{AB}$ = Projected alternative fuel price ceiling, plus taxes, for the boiler fuel consumed in a non-exempt use by the industrial facility, as determined in accordance with paragraph (b)(2)(i).

$\hat{RB}$ = Projected rate per million Btu's (excluding any incremental pricing surcharge), plus taxes, at which the industrial facility will purchase natural gas for non-exempt boiler fuel use, as determined in accordance with paragraph (b)(3)(i).

$\hat{VB}$ = Projected volume of natural gas (at 1,000 Btu's per cubic foot) that the industrial facility will purchase from the natural gas supplier and use for non-exempt boiler fuel, as estimated for each of the months "1" (one) through "n" of the PGA period.

$\hat{AS}$ = Projected alternative fuel price ceiling, plus taxes, for all natural gas consumed in a non-exempt use other than as boiler fuel by an industrial facility, as determined in accordance with paragraph (b)(2)(ii).

$\widehat{RS}$ = Projected rate per million Btu's (excluding any incremental pricing surcharge), plus taxes, at which the industrial facility will purchase natural gas for consumption in a non-exempt use other than as boiler fuel, as determined in accordance with paragraph (b)(3)(ii).

$\widehat{VS}$ = Projected volume of natural gas (at 1,000 Btu's per cubic foot) that the industrial facility will purchase from the natural gas supplier in excess of otherwise exempt volumes and an average of 300 Mcf per day and consume in a use other than as boiler fuel, as estimated for each of the months "1" (one) through "n" of the PGA period.

$\widehat{T}$ = Projected total percentage tax rate reflecting any state and local taxes applicable to an incremental pricing surcharge.

n = Last month of the PGA period.

(2) Projected alternative fuel price ceilings. (i) Non-exempt boiler fuel use. As a value for "$\widehat{AB}$" for each of the months "1" (one) through "n" of the coming PGA period, a natural gas supplier shall use the most recently established alternative fuel price ceiling applicable to the facility's non-exempt boiler fuel use, plus taxes, unless the supplier elects to estimate the applicable alternative fuel price ceilings for each month. In that case, the estimated ceilings, plus taxes, may be used as values for "$\widehat{AB}$".

(ii) Non-exempt use other than boiler fuel. As a value for "$\hat{A}S$" for each of the months "1" (one) through "n" of the coming PGA period, a natural gas supplier shall use the most recently established alternative fuel price ceiling applicable to the non-exempt use of gas other than as boiler fuel in the facility, plus taxes, unless the supplier elects to estimate the applicable alternative fuel price ceilings for each month. In that case, the estimated ceilings, plus taxes, may be used as values for "$\hat{A}S$".

(iii) Assistance for local distribution companies. If a local distribution company desires assistance in estimating applicable alternative fuel price ceilings for each of the months of the coming PGA period, the interstate pipeline which supplies the local distribution company shall provide such assistance.

(3) Projected rates. (i) Local distribution company. (A) Non-exempt boiler fuel use. As a value for "$\hat{R}B$" for each of the months "1" (one) through "n" of the coming PGA period, a local distribution company shall use its effective boiler fuel industrial gas sales rate per million Btu's at the time of projection, plus taxes, but exclusive of any incremental pricing surcharges, unless the local distribution company elects to adjust such rate to reflect general rate changes which it is known will occur during the PGA period under

authority of a state or local regulatory body. If the local distribution company elects to adjust the rate, the values used for "$\widehat{RB}$" may reflect the adjustments for the months of the PGA period for which the adjustments are appropriate.

(B) Non-exempt use other than boiler fuel. As a value for "$\widehat{RS}$" for each of the months "1" (one) through "n" of the coming PGA period, a local distribution company shall use its effective non-boiler fuel industrial gas sales rate per million Btu's at the time of projection, plus taxes, exclusive of any incremental pricing surcharges, unless the local distribution company elects to adjust such rate to reflect general rate changes which it is known will occur during the PGA period under authority of a state or local regulatory body. If the local distribution company elects to adjust the rate, the values used for "$\widehat{RS}$" may reflect the adjustments for the months of the PGA period for which the adjustments are appropriate.

(ii) Interstate pipeline. (A) Non-exempt boiler fuel use. As a value for "$\widehat{RB}$" for each of the months "1" (one) through "n" of the coming PGA period, an interstate pipeline shall use its effective boiler fuel industrial gas sales contract rate per million Btu's at the time of the projection, plus taxes, but exclusive of any incremental pricing surcharges, unless the pipeline elects to adjust such rate to reflect rate changes which it is known will occur during the PGA period.

(B) Non-exempt use other than boiler fuel. As a value for "$\widehat{RS}$" for each of the months "1" (one) through "n" of the coming PGA period, an interstate pipeline shall use its effective non-boiler fuel industrial gas sales contract rate per million Btu's at the time of the projection, plus taxes, but exclusive of any incremental pricing surcharges, unless the pipeline elects to adjust such rate to reflect rate changes which it is known will occur during the coming PGA period.

* * * * *

15. Section 282.504 is amended by deleting the words "boiler fuel" from the term "industrial boiler fuel facility(ies)" in paragraphs (a), (c)(1), (c)(3), (c)(4), (d)(2) and (d)(3)(ii), and by revising paragraphs (c)(1) and (c)(2) to read as follows:

§ 282.504 Incremental pricing surcharge.

* * * * *

(c) Surcharges on non-exempt industrial facilities. (1) * * *

(i) * * *

(ii) * * *

(iii) For the period November 1, 1980, through October 31, 1981, a state may elect to allocate that portion of an industrial facility's surcharge as determined in accord with (i) or (ii) above which is applicable to non-boiler fuel use of natural gas and which exceeds 75 cents per Mcf to other non-exempt industrial facilities within the state.

(2) MSAC of a non-exempt industrial facility. (i) The MSAC of a non-exempt industrial facility for any calendar month shall be determined in accordance with the following formula:

$$M = \frac{[(AB-RB)(VB) + (AS-RS)(VS)]}{1+T}$$

where:

M = MSAC of the non-exempt industrial facility.

AB = Alternative fuel price ceiling, plus taxes, applicable to the boiler fuel consumed in a non-exempt use by the industrial facility during the subject calendar month.

RB = Rate per million Btu's (excluding any incremental pricing surcharge), plus taxes, at which the industrial facility purchased gas for consumption as boiler fuel in a non-exempt use from the natural gas supplier during the month.

VB = Volume of natural gas (at 1,000 Btu's per cubic foot) supplied by the natural gas supplier to the industrial facility for consumption as boiler fuel in a non-exempt use during the month, as determined in accordance with paragraph (c)(2)(ii).

AS = Alternative fuel price ceiling, plus taxes, applicable to consumption of gas in a non-exempt use other than as boiler fuel by the industrial facility during the subject calendar month.

RS = Rate per million Btu's (excluding any incremental pricing surcharge), plus taxes, at which the industrial facility purchased gas for consumption in a non-exempt use other than as boiler fuel during the month.

VS = Volume of natural gas (at 1,000 Btu's per cubic foot) supplied by the natural gas supplier and consumed in a use other than as boiler fuel by the industrial facility that is not otherwise exempt and that exceeds an average of 300 Mcf/day during the month, as determined in accordance with paragraph (c)(2)(ii).

T = Total percentage tax rate reflecting any state and local taxes applicable to an incremental pricing surcharge.

(ii)(A) For the period January 1, 1980, through October 31, 1981, the volume of natural gas supplied to a non-exempt industrial facility during a month may be determined in accordance with § 282.207.

(B)(1) Subject to clause (2), on and after November 1, 1981, the non-exempt volume of natural gas supplied by a natural gas supplier to a non-exempt industrial facility during a month shall be deemed to be the total volume of natural gas supplied to the facility during the month, unless the natural gas supplier serving the facility distinguishes the volumes used for non-exempt uses from the volumes consumed in exempt uses on the basis of submeter readings. If volumes consumed in non-exempt uses are so identified, such volumes shall be the basis for determining the MSAC of the industrial facility in accordance with clause (i).

(2) Certified monthly estimates determined in accordance with § 282.207 may be utilised to determine the volume of natural gas consumed in the facility for non-exempt uses for a period following November 1, 1981, *provided that* the owner or operator of the facility has obtained a purchase order for all submeters which will be needed in the facility by November 1, 1981, and such submeters will be installed within a reasonable period of time.

* * *

* * * * *

16. Section 282.506 is amended to read as follows:

§ 282.506 *Refunds*.

(a) *Non-exempt boiler fuel use*. The jurisdictional portion of any refund (including interest applicable thereto) which is attributable to that portion of service provided to and consumed as boiler fuel for a non-exempt use by industrial facilities prior to January 1, 1980, which had not been flowed through to such users as of December 31, 1979, shall be flowed through as a lump sum payment in appropriate amounts to each appropriate natural gas supplier for the benefit of such users. Such refunds shall be calculated on the basis of sales to such users during the period when the rates which give rise to the refund were in effect.

(b) Non-exempt use other than boiler fuel. The jurisdictional portion of any refund (including interest applicable thereto) which is attributable to that portion of service provided to and consumed in a non-exempt use other than as boiler fuel by non-exempt industrial facilities prior to [90 days following expiration of 30-day Congressional review period] which has not been flowed through to such users as of [day prior to day 90 days following expiration of 30-day Congressional review period] shall be flowed through as a lump sum payment in appropriate amounts to each appropriate natural gas supplier for the benefit of such users. Such refunds shall be calculated on the basis of sales to such users during the period when the rates which give rise to the refund were in effect.

17. Section 282.601 is amended in paragraph (c) to read as follows:

§ 282.601 FERC gas tariff provisions.

* * * * *

(c) Filing dates. The incremental pricing surcharge provision and revised PGA provision shall be filed with the

Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, N. E., Washington, D. C. 20426 and served on all parties by July 1, 1980. The provisions shall become effective on August 1, 1980, unless disapproved in whole or in part by the Commission.

18. Section 282.602 is amended in paragraph (a) to read as follows:

§ 282.602 Tariff sheets.

(a) General rule. (1) On or before August 1, 1980, for the period [90 days following expiration of 30-day Congressional review period], to the effective date of the pipeline's next normally scheduled PGA filing, each interstate pipeline shall file concurrently:

(i) a tariff sheet reflecting a reduced PGA rate as etermined in accordance with § 282.503; and

(ii) a tariff sheet reflecting the projected incremental ricing surcharges for each month, as determined on the basis f data used in deriving the reduced PGA rates referenced in lause (i), for each of the direct sale non-exempt industrial acilities and the aggregate amount applicable to each sale-for-esale customer on the pipeline's system.

* * * *

19. Section 282.603 is amended in paragraph (a) to read as follows:

§ 282.603 Informational filings.

(a) General rule. For informational purposes, each month commencing with September 1980, each interstate pipeline company shall file with the Commission a statement setting forth the incremental pricing surcharge actually billed to each non-exempt industrial facility and sale-for-resale customer on its system in the preceding month.

* * * *

APPENDIX A

SUMMARY OF COMMENTS ON PHASE II RULEMAKING

The attached chart is a summary of the oral comments made in the hearings and the written comments submitted in response to the Notice of Proposed Rulemaking in Docket No. RM80-10. The comments have been organized according to interest group. 1/

A total of 522 comments were received on the Phase II proposal. This total includes 347 comments on behalf of industrial end-users; eleven comments from Chambers of Commerce; seven comments on behalf of consumer organizations or individual consumers; thirteen comments on behalf of natural gas liquids extraction plants; and sixteen comments on behalf of pipeline companies. Local distribution companies filed a total of sixty-four comments; sixteen state regulatory Commissions participated in the proceedings; and three Federal agencies submitted comments. Finally, forty-five Congressmen submitted views or formal comments.

Commenters addressed numerous issues inherent in the Phase II proposal. For purposes of this summary, the issues have been grouped into ten major categories. An "X" placed in a

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1/ Several individuals submitted comments over their own names, arguing an industrial point of view. These comments are included within the "industrial end-user" group.

column indicates that the commenter discussed at least one issue within that particular category. The ten categories include the following issues:

Timing: includes comments requesting the Commission to delay implementing a Phase II rulemaking because of lack of information on the impact of incremental pricing and/or lack of experience with implementing the Phase I program.

Scope: includes comments requesting the Commission to expand or limit the class of gas users, or the type of gas use covered by incremental pricing.

No. 2 or No. 6: includes comments that recommended a ceiling price to be adopted by the Commission. All except a few of these comments recommended adopting a single tier high sulphur No. 6 ceiling price.

Market Ordering: includes comments that expressed the view that the incremental pricing program will not be able to meet its market ordering objectives because it will not be able to restrain pipeline bidding for new supplies of gas.

Price Sheltering: includes comments that express the view that the incremental pricing program will not achieve its objective of shielding high priority users. The arguments in support of this position included views that high priority users will not receive a benefit because load loss will result on many systems, causing an increase in rates to the high priority users, and that the increased gas prices paid by incrementally priced industrials will be passed on to the high priority users in the form of higher prices for consumer products.

Adverse Economic Impact: includes comments indicating that incremental pricing will have any of the following economic impacts: increase inflation, increase unemployment, decrease rate of growth, increase balance of payment deficit, cause plant shutdowns and create competitive disadvantages in the foreign and/or domestic markets.

Increase Oil Use: includes comments stating that the incremental pricing program will cause fuel switching from gas to oil because the price of gas will be equal to or exceed the price of oil. Thus, U.S. dependence on oil imports will be increased.

Load Loss: includes comments that alleged that the incremental pricing program will cause fuel switching from gas to alternative fuels for many industries, which will increase the fixed costs the remaining customers on the gas system will have to bear.

Conservation: includes comments alleging that incremental pricing hides the true cost of gas to high priority users, thus creating a disincentive to conserve.

Keep Estimation Procedure: includes comments opposing a submetering requirement and recommending permanent adoption of an estimation approach. The majority of these comments endorsed the disclosed estimation methodology approach adopted by the Commission in Docket No. RM80-16.

Attachment

APPENDIX A
SUMMARY OF COMMENTS ON PHASE II RULEMAKING

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER- VATION	KEEP ESTIMATION PROCEDURE
Acme Brick		x	x			x				
Active Products Corp.		x				x	x			
Adams Packing Assoc. Inc.					x	x				
Advance Products Corp.					x		x	x		
AF Enterprises		x								
AFG Indust. Inc.						x		x		
Air Products & Chemicals		x				x				
Airco Speer Carbon-Graphite		x	x		x	x	x			
Akrosil			x			x				
Alberto-Culver Co.					x	x	x	x		
Alcoa Aluminum										
Alflex Corporation						x			x	
Allis Chalmers						x	x	x		
Allshouse, Thomas W.						x				
Alleun Juices, Inc.						x				
Aluminum Recycling Association		x								
American Aluminum Extrusions, Inc.		x	x			x	x			
American Bakers Assoc.		x				x				
American Die Casting Institute		x	x	x		x	x	x	x	x
American Hot Dip Galvanizing		x				x	x		x	
American Institute of Plant Engineers		x	x			x				
American Iron Ore Association		x	x	x		x	x			

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
American Meat Institute and Armour & Co.		x	x		x	x	x			
American Paper Institute, Inc.		x	x			x			x	
American Standards Inc.		x	x	x	x	x		x		
American Textile Manufacturers Institute, Inc.		x	x	x	x	x	x		x	
Ames Company					x	x	x			
Amron Corporation		x								
Anaconda Copper Co.		x	x	x		x	x		x	
Anaheim Citrus Products Co.		x				x				
Anchor Hocking Corp.		x				x	x	x	x	
Armco Incorp.		x	x			x		x	x	
Armstrong		x		x	x	x	x	x	x	
Armstrong Cork		x	x							
Asarco Inc., Deere & Co., Kennecott Copper Corp.		x	x	x	x	x			x	
Asset Management Consultant Serv. Inc.		x				x				
Associated Industries of Alabama		x	x		x	x		x	x	
Associated Industries of Kentucky		x			x			x		
Atkinson Brick Co.	x	x				x				
Atlantic Richfield Co.		x	x			x	x	x	x	
Atlas Powder Company		x				x		x		
Austin White Lime Co.		x								
Avery International										
As Products Co.		x	x			x	x	x		

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Baker Canning Co., Inc.					x	x			x	
Ball Corporation		x	x			x	x	x	x	
Bethlehem Steel Co.						x				
Bickerstaff Clay Products, Inc.		x	x			x				
Bordo Citrus Products Coop.			x			x	x	x		
Boxen Clay Products						x				
Borg Warner Chemicals			x			x			x	
Brian, Allen E.						x				
Brick Institute of America			x		x	x	x			
Briggs		x				x				
Briggs and Stratton Corp.			x			x	x	x		
Broce Construction Co., Inc.					x	x				
Brookside Corp.		x				x				
Brunswick Corp.					x	x				
Bud Darden Mobile Homes		x								
Burgess Pigment Co.		x	x		x	x				
Burrell Implement Co.						x				
Burlington Industries		x	x	x	x	x	x			
Butcher Boy Food Prod., Inc.		x				x				
Cabot Corporation		x	x			x				
California Asphalt Pavement Assoc.			x		x	x				
California Carpet Finishing Co.		x								
California Gas Producers Assoc.		x				x				

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
California Manufacturers Assoc.		x				x		x		
Can Tex		x	x			x				
Cardinal American Corp.						x				
Carlton Forge Works						x				
Cast Metals Federation	x	x	x			x				
Caterpillar Tractor Co.	x	x	x	x		x		x		
Celanese Fibers Co.		x			x		x			
Cello Bag Co., Inc.										
Celotex Corporation			x		x	x	x	x		
Central Illinois Industrial Ass.		x	x			x		x		
Central Nebraska Packing, Inc.						x				
Certain Associations & Industrial Users of Natural Gas	x	x	x	x		x		x		
CertainTeed Corp.	x	x	x						x	
CF&I Steel Corporation		x			x	x				
Champion Spark Plug Co.		x								
Chattanooga Glass Co.						x	x			
Chemical Manufacturers Assoc.	x	x		x				x	x	
Chicago Bridge & Iron Co.		x	x				x			
Chicago Extruded Metals Co.		x								
Chi-Vit Corporation						x	x			
Cleveland-Cliffs Iron Co.		x			x	x				
Colonial Rubber Co.		x				x			x	
Columbia Moulding Co.					x	x		x		

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MASKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Consolidated Papers, Inc.			x					x		x
Construction Industry Mfgrs. Association			x		x			x		
Copperweld Tubing Group						x		x		
Corn Refiners Assoc., Inc.										
Cortland Container Corp.		x								
Crompton Company, Inc.			x							
Crown Cork and Seal Company, Inc.			x			x	x	x		
Dana Corporation		x			x				x	
Delta Brick & Tile Co., Inc.		x	x		x	x				
Dickey Company			x		x		x	x	x	
Dixie Galvanizing & Tank Co.						x	x	x		
Dixie Industries Inc.		x			x	x				
D.H. Steward Mfgr. Co.						x				
Dow Chemical U.S.A.		x		x					x	
Dubuque Packing Co.		x				x				
Dundee Citrus Growers Assoc.		x		x	x	x	x			
Du-wel Products, Inc.		x	x			x				
E. I. DuPont de Nemours & Co.	x	x	x	x		x		x	x	
Eastern Energy User's Coalition	x	x		x		x				
ECK Industries, Inc.						x				
Electrodelta Inc.		x				x				
Eli Lilly and Co.		x				x				x

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELR'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KERP ESTIMATION PROCEDURE
Eljer Plumbingware										
Elkay Manufacturing Co.					x	x		x		
Ellwood City Forge Corp.					x			x		
Elyria Foundry Division		x				x				
Emerson Electric Co.		x								
Enamel Products & Plating Co.		x	x			x				
Endicott Forging & Manufacturing Co., Inc.										
Endicott Clay Products Co.						x		x		
Entex, Inc.										
Erie Mining Co.		x			x	x	x	x		
Evans Cooperage Co.				x		x	x	x		
Expert Witness Services, Inc.						x			x	
					x	x	x	x		
Famous Fabric Shop		x								
Fenton Art Glass Co.										
Ferro Corporation		x								
Fertilizer Institute	x	x			x	x	x			
Firestone Tire & Rubber Co.						x				
Flambeau Paper Corp.		x	x			x				
Flamingo Tile Corp.						x				
Flexible Packaging						x				
Florida Distillers Co.			x			x		x		
Florida Steel Corp.		x					x	x		
Florida Wire & Cable Co.						x				
Flowerwood		x				x	x			

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Ford Motor Co.	x	x	x	x					x	
Forging Industry Assoc.						x	x			
Frederick J. Dando Co.						x				
GAF Corporation						x				
Gamble Brothers, Div. of Celotex Corp.										
Gatke Corp.										
General Foods Corp.						x	x			
General Tire & Rubber Co.		x	x			x				
Georgia Pacific Corp.		x	x						x	x
Georgia Marble Co.					x	x				
Giant Portland & Masonry Cement Co.	x	x		x		x		x		
Gladding, McBean and Co.						x		x		
Glass Containers Corp.	x	x	x	x		x				
Glass Packaging Institute	x	x	x	x		x				
Glen-Gery Corp.							x			
Gohman Asphalt & Construction, Inc.				x		x	x			
Goodyear Tire & Rubber Company		x	x						x	
Gopher Smelting & Refining Co.					x	x				
Grain Processing Corp.						x	x		x	
Grede Foundries Assoc.						x	x			

Industrial End-Users

	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Greenlee Tool Co.										
Grocery Manufacturers of America, Inc.						x	x			
GTE Products Corp.		x	x	x	x					
Gulf & Western Industries, Inc.										
Gypsum Assoc.						x	x	x		
Haines City Citrus Growers Assoc.										
Helltown Paperboard Co.						x	x	x		
Hamilton Die Cast, Inc.										
Hanley Brick, Inc.		x				x				
Hanna Mining Co.		x	x	x	x	x				
H. C. Spinks		x	x			x		x		
Harsco Corp.	x					x	x			
Herbert Materials, Inc.		x				x	x			
Hercules, Inc.		x				x	x		x	
Homer Laughlin China Co.						x	x	x		x
Hormel & Co.						x				
Hoover Radiator		x				x	x	x		
Howmet Turbine Components Corp.										
Huntington Almoys	x	x				x				
Huron Lime Co.			x			x	x	x	x	
Husky Oil Co.		x								
Hussey Metals Div. Copper Range Co.		x	x			x x				

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Ideal Basic Indust. Inc.		x	x			x				
Illinois Road Builders Assoc.						x				
Imperial Glass Corp.		x				x	x	x		
Indiana Farm Bureau Cooperative Assoc., Inc.										
Inland Container Corp.		x	x			x	x	x		
Inland Steel Container					x	x				
International Harvester		x	x			x				
International Minerals & Chemical Corp.						x				
Interstate Brick & Ceramic Tile						x				
Janquin Florida Distilling Co.			x		x	x				
Jessop Steel Co.						x				
Jim Walter Corp.		x	x				x			
Johns-Manville, Inc. et al.		x	x	x		x		x	x	
John Morrell & Co. (Esterville plant)		x				x				
Kaiser Aluminum		x	x			x	x			
Kennecott Copper Corp.				x	x	x	x			
Kenosha Beef										
Kent Castings Corp.										
Kimberly-Clark Corp.	x		x			x	x	x		x
Knauf Fiberglass		x	x		x					

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Knudsen Corp.					X	X			X	
Koppers Co.	X	X				X				
Korf Industries, Inc.		X				X	X	X		X
Kropp Forge Co., Div. of Anadite, Inc.		X				X				
Ladish Company			X			X	X			
Lake Wales Citrus Growers Assoc.					X		X	X		
Larsen Company	X	X		X	X	X		X	X	
LaSalle Steel Co.		X	X	X		X				
Lenox, Inc.			X		X	X	X	X		
Libbey-Owens-Ford Co.		X	X			X			X	
Logan Clay Products Co.		X				X				
L&M Paving and Construction		X			X	X	X			
Lyon Metal Products Inc.						X				
Man Made Fiber Producers Assoc.		X				X				
Mansfield Products Co.		X								
Manufacturers Assoc.						X				
Mars, Inc.	X			X		X	X	X		
Maytag Co.	X	X	X		X	X	X	X		X
Mayville Metal Products Co.						X	X		X	
McDanel Refractory Co.						X				
Merrick Foods								X		
Michigan Brick						X				
Midland Forge, Inc.						X	X	X		
Milwaukee Solvay Coke Co.	X	X				X	X	X		

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Minnesota Mining & Manufacturing		x	x			x				
Miracle Recreation Equipment Co.						x				
Mississippi Valley Mill Producers Assoc. Inc.						x		x		
Mobay Chemical Corp.		x				x			x	
Mobley, Green, Harrison & Gardner		x								
Monarch Ranges and Heaters						x				
Morbeck, Charles T. .						x	x			
Motorola, Inc.		x								
Musser, N. C.					x	x	x			
National Assoc. of Manufacturers		x	x				x	x	x	
National Asphalt Pavement Assoc.							x			
National Clay Pipe Institute		x				x			x	
National Council of Farmer Cooperatives	x	x	x			x		x		
National Grain and Feed Assoc.										
National Gypsum Co. and American Olean Tile Co., Inc.	x	x	x			x			x	
National Renderers Assoc.										
Nevada Industrial Customers										

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Northern Petrochemical Co.		x	x			x	x			
N-Ren Corporation						x				
Nucor Steel		x								
O. Hommel Company										
Olin Corporation		x		x	x	x				
Orange Plating, Inc.		x	x		x	x	x			
Orange-Co of Florida, Inc.						x		x		
Oscar Meyer & Co., Inc.	x									
Ottawa Silica Co.						x				
Overhead Door Corp.						x				
Overmyer Corp.										
Owensboro Brick & Tile Co.						x			x	
Owens-Corning Fiber-Glass Corp.		x	x	x	x					
Owens-Illinois					x	x		x		
Parker Hannifin Corp.										
Paul Krone Diecasting, Inc.										
Peat Manufacturing Co.						x			x	
Perstorp, Inc.			x			x	x			
Petrochemical Energy Group	x	x	x	x						
Pfaltzgraff Co.						x	x		x	
Pharr Yarns Corp.		x				x	x			
Phelps Dodge Corp.		x	x							
Pickard Inc.		x				x				
Plantmix Asphalt		x								
Porcelain Enamel Inst., Inc.		x	x			x	x	x		

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Port Costa Products Co.						x				
Potters Industries, Inc.		x				x				
PPG Industries, Inc.						x				
Process Gas Consumers Group et al.	x	x	x	x	x	x	x	x	x	x
Proctor & Gamble	x	x		x		x		x	x	
Productol Chemical Div.						x		x		
Quaker Oats Co.		x	x							
Rachelle Laboratories						x			x	
Reedsburg Foods Corp.					x	x	x	x		
Reeves Southeastern Corp.		x	x		x	x	x			
Refractories Institute					x	x	x			
Reichold Chemicals, Inc.					x	x				
Reliance Clay Products					x	x	x			
Remington Arms Co. Inc.		x								
Renninger, Richard D.	x						x			
Republic Steel Corp.		x				x			x	x
Reserve Mining Co.		x	x			x				
Rex of Florida, Inc.		x	x			x	x			
Reynolds Aluminum	x	x					x			
RMI Titanium Company		x				x	x	x	x	

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Industrial End-Users

	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Roberts Brothers,										
Inc.										
Rockwood Industries										
R.R. Donnelley &		x				x	x			
Sons Co.						x		x	x	
St. Joe Paper				x		x				
Company									x	
SBS		x		x						
Schenley Distillers,		x			x	x	x			
Inc.						x				
SCM Organic		x	x							
Chemicals						x	x	x		
Scrap-All, Inc.										
Service Master of		x	x		x	x	x			
Fox Cities, Inc.					x	x	x			
Signode Corporation		x								
Sikes Corp.						x				
Sioux City Brick and		x			x	x			x	
Tile Co.						x	x	x		
Sioux City Stock		x								
Yards					x					
Sipple Brick, Inc.										
SJC Corp.		x	x			x				
Sno-White Laundry						x				
and Dry Cleaners						x	x	x		
Society of Plastic,		x							x	
Ind. Inc.										
Somerset Ceramics		x	x							
South Dakota Press					x	x		x		
Assoc.										
Southeastern Bolt &		x								
Screw										
Southeastern Steel										
Container Co.		x			x	x				

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Southern Nevada Industrial Customers	x	x	x	x		x				
Southwest Steel Casting Co.		x								
Spencer Foods, Inc.		x			x	x				
Standard Oil Co. (Indiana)		x				x				
Stauffer Chemical Co.						x				
Stitt, Jack & Linda		x				x				
Structural Stoneware, Inc.						x				
Sundstrand Heat Transfer Inc.		x				x	x	x		
Sunpac Foods Inc.		x			x	x	x			
San Valle Tile Kilns		x		x	x	x				
Swank Refractories Co.										
Swenson Spreader										
Sybron Corp.										
Sylvania		x			x	x	x			
Tempel Steel Co.										
Tennessee Eastman Co.		x		x	x	x				
Terra Chemicals			x			x				
Timken Company		x	x		x	x		x	x	
TRW		x								
United Brick & Clay Workers of America		x								
U.S. Brewers Assoc., Inc.	x	x				x				x

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
U.S. Pipe & Foundry Co.	x					x	x			
United States Tile Co.	x					x				
U.S. Steel Corp.		x				x	x	x		
United Technologies Corp.						x	x			
Utah Mining & Mfgr. Assoc.	x	x								
Valmont Industries, Inc.						x		x		
Vertac Chemical Corp.						x				
Viking Glass Company						x				
Vitreous Steel Products Co.	x					x				
Wallace Murray Fiberglass Products					x	x				
Waverly Growers Cooperative					x	x				
Welch Foods, Inc.					x	x				
Western Lime & Cement Co.		x		x		x				
Western States Clay Products Assoc.	x					x				
Whirlpool Corp.		x	x	x	x	x				
White Pine Copper Division of Copper Range Co.		x	x			x				x
Wilson Concrete						x				

Industrial End-Users	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Wine Institute										
Wonderling, Craig M.		x				x				
Worthington Industries						x				
Young Galvanising, Inc.					x	x	x			
Chambers of Commerce										
California Chamber of Commerce	x	x	x							
Cleveland Bradley Chamber of Commerce		x			x	x				
Council Bluffs Chamber of Commerce		x			x	x		x		
Duluth Chamber of Commerce		x			x					
Illinois State Chamber of Commerce		x	x			x	x	x		
Kentucky State Chamber of Commerce		x			x	x	x		x	
Lincoln Chamber of Commerce						x				
Louisville Chamber of Commerce		x			x	x	x			
Springfield Chamber of Commerce		x				x				
St. Paul Area Chamber of Commerce			x		x	x		x		
U.S. Chamber of Commerce										

Consumer Groups	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Consumer Energy Council of										
Fernandez, N. R.		x				x				
Halt Rip-off Committee						x				
Hasselbach, John		x				x				
Herman Energy Services		x				x				
National Consumer Law Center, Inc.		x	x		x			x		
Shirley, Donald T.						x				
NGL Extraction Plants										
Chemplex Col										
Cities Service Co.		x	x			x				
Gas Processors Assoc.		x		x		x				
Gulf Oil Corp.		x			x	x				x
Mapco Inc.		x		x		x			x	
Mitchell Energy Corp.		x				x				
National Distillers and Chemical Corporation		x	x	x	x	x				
National Helium Corp.		x		x	x	x				
National LP Gas Assoc.		x		x	x	x				
Northern Gas Products Co.		x								
Straddle Plant Group		x		x		x	x			
Sun Oil		x		x		x	x			
Union Oil Co. of California		x								

Pipeline Companies	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Cities Service Gas Co.		x	x	x	x	x	x	x		
Colorado Interstate Gas Co.	x	x		x	x	x	x		x	
Columbia Gas Transmission Corp.			x	x	x			x		
Commonwealth Gas Pipeline Corp.	x	x		x		x		x		
Consolidated Gas Supply Corp.		x	x			x	x	x	x	
East Tennessee Natural Gas Co.	x	x	x			x	x	x		
Florida Gas Transmission Co.		x		y		x	x	x		
Interstate Natural Gas Association of America		x	x	x	x	x		x		
Mississippi River Transmission Corp.	x	x	x			x	x	x	x	
Natural Gas Pipeline Co. of America	x		x	x		x	x	x		x
Northern Natural Gas Co.		x	x	x		x	x	x		x
Northwest Pipeline Corp.	x	x	x	y		x	x	x	x	
Southern Natural Gas Co.			x					x		
Southwest Gas Corp.										
Texas Gas Transmission Corp.										
United Gas Pipeline Co.		x	x	x		x		x	x	

Public Utilities - Cities

	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER- VATION	KEEP ESTIMATION PROCEDURE
Alabama Gas Corp.		x	x					x	x	
American Gas Assoc.	x	x	x	x	x	x	x	x		x
Boonville Natural Gas Co.		x						x		
Boston Gas Co., Providence Gas Company and Brooklyn Union Gas Co.		x		x	x					
Brownsville Utility Dept.		x				x		x		
Carrollton Utilities		x					x	x		
Central Florida Gas Corp.		x	x			x	x			
Columbia Gas Distribution Cos.	x	x	x	x	x	x	x	x	x	
Connecticut Natural Gas Co.	x	x	x			x		x		
Covington, Tennessee		x						x		
Crockette Public Utility District										
Duke Power Co.										
Elizabethtown, KY		x								
Elizabethtown Natural Gas										
Florida Public Utilities Co.		x	x			x				
Gas Light Co. of Columbus, GA						x				
Gas Utilities Co.		x						x		
Gibson County Utility District		x	x					x		
Great River Gas Co.		x								
Grey, Robert P., Consultant		x								

Public Utilities - Cities	TIMING	SCOPE	NO. 2 NO. 6	MASKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Hamilton, Ohio		x						x		
Humboldt Utilities		x								
Illinois Gas Co.		x					x	x		
Indiana Gas Co.		x	x		x	x	x	x		x
Indiantown Gas Co.		x				x				
Iowa-Illinois Gas and Electric Co.	x	x			x	x	x			
Iowa Public Service Co.		x			x	x	x	x		
Jackson Utility Division		x			x	x		x		
Kyle Associates, Inc.		x	x				x			x
City of Louisville		x	x			x	x	x	x	
Louisville Gas & Electric	x	x								
Louisiana Gas Service		x	x		x		x			
Memphis Light, Gas & Water Division										
Midwest Natural Gas Corp.		x								
Missouri Power & Light Co. and Missouri Edison Co.						x	x	x		
Mississippi Valley Gas Co.	x	x								
Montana-Dakota Utilities Co.		x	x	x	x					
Mountain Fuel Supply Co.		x	x	x		x		x		x
Municipalities for Small Industrial Consumers										
Murray Natural Gas System		x						x		

Public Utilities - Cities	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
National Gas and Oil Corp.	x	x	x			x			x	
New Jersey Natural Gas Co.	x	x	x	x			x	x		
Northern Illinois Gas Co.	x	x	x					x		x
Northern Indiana Public Service Co.		x	x	x		x	x	x		x
Northern States Power Co.		x	x	y		x	x			x
Pacific Gas & Electric Co.		x	x	x				x		x
Peoples Gas System		x	x		x	x	x	x		
Piedmont Natural Gas Co., Inc.					x		x			
Public Serv. Co. of Colorado	x			x				x		
Public Service Electric & Gas Co. (N.J.)			x			x				
Roanoke Gas Co.					x	x	x	x	x	
San Diego Gas & Electric Co.	x		x		x	x		x		x
South Carolina Electric & Gas Co.		x				x	x	x		
Southern California Gas Co.		x	x			x		x		x
Southern Connecticut Gas Co.			x			x	x	x		
Southern Union Co.		x								
Sun Gas Co.										
Terre Haute Gas Corp.		x				x	x			
UGI Corp.	x	x	x	x						

Public Utilities - Cities	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
United Cities Gas Co.					x	x	x	x		
United Distribution Cos.	x	x	x	x	x	x	x	x	x	x
Western Kentucky Gas Co.		x	x		x	x		x	x	
Wisconsin Public Serv. Corp.	x		x							x

State Regulatory Agencies	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Connecticut Public Utilities Control Authority et al.			x		x			x		
Kentucky Dept. of Commerce					x	x	x			
Michigan Dept. of Commerce										
Michigan Public Service Commission		x	x	x		x		x		
Minnesota Public Service Commission	x	x	x	x		x	x	x	x	
Mississippi Public Service Commission	x		x							
NARUC	x	x						x		
New York State Consumer Protection Board		x	x							
North Carolina Utilities Comm. et al.	x	x	x	x	x	x	x	x		
Public Service Commission of the State of Nevada										
Public Utilities Comm. of Calif.	x		x							
Public Utilities Commission of Ohio		x	x	x						
State of Wisconsin Dept. of Administration		x	x			x	x			

State Regulatory Agencies	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Utah Committee of Consumer Services										
Wisconsin Public Service Commission			x							x
Wyoming Public Service Commission			x		x			x		
Federal Agencies										
Council on Wage & Price Stability						x				
Department of Energy	x	x	x	x	x	x	x	x	xx	
Economic Regulatory Adm., DOE		x		x		x				

U.S. Congressmen

	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
Anderson, John	x					x				
Archer, Bill	x	x	x		x	x		x		
Ashley, Ludlow						x				
Aspen, Les						x	x	x		
Bailey, Don	x	x	x		x	x		x		
Baldus, Alvin		x								
Beard, Robin						x		x		
Benjamin, Adam	x	x	x		x	x		x		
Bowen, David R.	x	x	x		x	x		x		
Broyhill, James T.	x	x	x		x	x		x		
Buchanan, Joho	x	x	x		x	x		x		
Butler, M. Caldwell	x	x	x		x	x		x		
Chiles, Lawton						x	x			
Collins, James M.	x	x	x		x	x		x		
Corcoran, Tom	x	x	x		x	x		x		
Dannemeyer, William E.	x	x	x		x	x		x		
Derrick, Butler	x	x	x		x	x		x		
Dickenson, William L.	x	x	x		x	x		x		
Dingell, John	x	x	x	x						
Eckhardt, Bob	x	x	x	x						
Erlenborn, John N.	x	x	x		x	x		x		
Fountain, L. H.	x	x	x		x	x		x		
Gibbons, Sam	x	x	x		x	x		x		
Gramm, Phil	x	x	x		x	x		x		
Gudger, Lamar	x	x	x		x	x		x		
Guyer, Tennyson	x	x	x		x	x		x		
Hinson, Jon	x	x	x		x	x		x		
Hyde, Henry J.	x	x	x		x	x		x		
Ireland, Andy	x	x	x		x	x		x		
Kemp, Jack F.	x	x	x		x	x		x		
Kindness, Thomas N.	x	x	x		x	x		x		
Livingston, Bob	x	x	x		x	x		x		
Long, Gillis W.	x	x	x		x	x		x		
Lott, Trent	x	x	x		x	x		x		
Luken, Thomas A.		x								

U.S. Congressmen	TIMING	SCOPE	NO. 2 NO. 6	MARKET ORDER.	PRICE SHELT'G	ADVERSE ECONOMIC IMPACT	INCRS. OIL USE	LOAD LOSS	CONSER-VATION	KEEP ESTIMATION PROCEDURE
O'Brien, George M.	x	x	x		x	x		x		
Preyer, Richardson	x	x	x		x	x		x		
Quillen, James H.	x	x	x		x	x		x		
Stockman, Dave	x	x	x		x	x		x		
Stone, Richard						x	x			
Treen, David		x		x		x	x	x	x	
Walker, Robert S.	x	x	x		x	x		x		
Weaver, Jim			x							
Whitehurst, G. William	x	x	x		x	x		x		
Wilson, Charles	x	x	x		x	x	x			

APPENDIX B

Estimate of Volumes Subject to the Phase II Rule

In order to estimate the direct industrial cost impact of the final rule, data from the EIA-50 reporting form have been analyzed. Four industries were considered in detail; chemicals; petroleum; stone, clay and glass; and primary metals (SIC codes 28, 29, 32, and 33 respectively). In the Environmental Assessment accompanying this rule it was determined that these four industries account for nearly 80% of total non-boiler gas use in manufacturing. 1/ Table A-1 reproduces the relevant table from the Environmental Assessment.

1/ Environmental Assessment of Incremental Pricing - Phase II, Docket No. RM80-10, Federal Energy Regulatory Commission, Office of Pipeline and Producer Regulation, April 1980, page 12.

TABLE A-1

1976 MANUFACTURING SECTOR NATURAL GAS CONSUMPTION
BY INDUSTRY AND END USE[a]

SIC Code	Industry	Natural Gas Use (10^{12} Btu) Boiler[b]	Process Heat	Feed-Stock	Other[c]	Total	% of Nonboiler Gas Use[d]
20	Food	358	119	-	1	478	3
22	Textiles	44	40	-	-	84	1
26	Paper	293	72	-	1	366	2
28	Chemicals	1062	450	474	198	2184	25
29	Petroleum	251	713	-	16	980[e]	19
32	Stone, Clay and Glass	30	593		-	623	16
33	Primary metals	348	661	-	40	1049[e]	18
	Other manufacturing	270	588	-	6	864	16
All manufacturing		2656	3236	474	262	6628	100
Functional Use as % of Total Manufacturing		40	49	7	4		100

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a/ Included intrastate consumption.

b/ Boiler use includes space heating, electric generation, and process steam.

c/ Other includes machine drive, lighting, space cooling, and miscellaneous uses not explicitly specified in this table.

d/ Nonboiler includes process heat and feedstocks.

e/ Only purchased natural gas is shown for the petroleum and steel industries. Refinery gas accounts for roughly one quad of gaseous fuel use in SIC 29, and coke oven gas contributes approximately 0.3 quads of gaseous fuel use in steel.

SOURCE: EEA, "Energy Consumption Data Base, 1976" (interim results), December 1979.

Because the EIA-50 data does not distinguish between boiler and non-boiler use of gas, an estimate of non-boiler use had to be developed independently. Again relying upon information developed in the Environmental Assessment, the fraction of gas used for purposes other than boiler fuel in the four industries studied was estimated on a national basis as follows:

SIC Code	Industry Description	Percent Used In Non-Boiler Applications
28	Chemicals	51.37%
29	Petroleum	74.39
32	Stone, Clay, Glass	95.18
33	Primary Metals	66.83

These percentages were used to adjust the EIA-50 data for each gas consuming facility, in order to derive an approximation of the volumes subject to Phase II. The most recent annual set of data from EIA-50 was used, running from April of 1978 to March of 1979. The data from Texas, Oklahoma, New Mexico, Alaska, and Hawaii were excluded in order to reflect only interstate gas consumption.

After adjustment to reflect non-boiler use, the analysis proceeded by subtracting from the monthly gas use reported by each facility a quantity equal to 300 Mcf multiplied by the number of days in the subject month. This yields an estimate of the small use exemption. If, in any month, less gas was consumed than the allowable exempt volume, incrementally priced consumption for that month was set equal to zero. For each facility, a ratio was developed comparing the total annual volume subject to Phase II with the total annual estimated non-boiler use. This "coverage ratio" reflects the proportion of a facility's annual consumption that is subject to Phase II of incremental pricing. A value of zero indicates that no gas is surcharged. A value close to unity (1.0) indicates that almost all gas is subject to incremental pricing. Because the first 300 Mcf per day of gas is exempt for all facilities, the ratio must always be less than unity.

The coverage ratio is then used to derive the effective average surcharge applicable to non-boiler Phase II uses. For example, if the ratio for a given facility is 0.5, half the gas consumed on an annual basis is incrementally priced. So if the surcharge is estimated to be 60 cents per Mcf and half of the facility's consumption will be surcharged, the average price increase resulting from Phase II would be 30 cents per Mcf. If the coverage ratio of another facility is 0.4, the average price increase works out to 24 cents per Mcf. Obviously, if the coverage ratio is zero, all gas is exempted, and the average price increase is also zero.

In this analysis of economic impact, industry coverages were computed and grouped by deciles. On a state-by-state basis, and for each of the four SIC codes analyzed, the facilities are categorized into those having coverage ratios greater than or equal to zero but less than 0.1, greater than or equal to 0.1

but less than 0.2, and so forth. Data is also summed across all states to provide a national picture of the extent of incremental pricing under Phase II. Along with the coverage ratio data, volumes subject to Phase II and estimated non-boiler volumes are listed by SIC code, by state and nationally. From these basic data, estimates of the aggregate direct cost impact of Phase II on industrial users may be derived by multiplying non-exempt volumes by the applicable surcharge.

Results

The national summary indicates the following potential direct cost impact of Phase II, based on volumes as reflected in the most current 12 months of EIA-50 data: 2/

SIC Code	Estimated Non-Boiler Use (Mcf)	Estimated Volume Subject to Phase II (Mcf)	Percent of Non-Boiler Use Subject to Phase II
28	246,309,699	198,020,672	80.40%
29	176,199,695	155,511,318	88.26
32	380,361,341	297,001,388	78.08
33	374,157,181	314,283,660	81.97
TOTAL	1,177,027,916	964,826,038	81.97

The aggregate impact of Phase II is generally consistent across the industries studied. The higher percentage of gas subject to incremental pricing in the petroleum industry (SIC 29) probably results from the large facility sizes typical in

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2/ These figures do not reflect any other exemptions such as agriculture or cogeneration.

the industry. On the other hand, the smaller facility sizes typical in the stone, clay and glass industries (SIC 32) give rise to an aggregate exposure to incremental pricing somewhat lower than the four industry average.

Examination of the coverage ratio data provides further insight on expected impacts (see Table 1). In the Chemical industry (SIC 28), 382 facilities out of a total of 706 fell into the lowest decile. These 382 facilities would be subject to incremental pricing for less than 10% of their gas consumption. The average impact on each such facility would range from zero to six cents per Mcf. Thus, over half of the facilities in the chemical industry would experience little or no direct cost impact from Phase II. The spread among higher deciles is relatively uniform. The highest decile contains 55 facilities, or about 8 percent of the total, but consumes approximately 65 percent of total non-boiler use in the chemical industry. These larger facilities would receive an average price increase ranging between 54 cents and 60 cents per Mcf.

The petroleum industry has a lower percentage of small facilities; only 59 out of 235, or 25 percent, fall into the lowest decile. The remaining facilities are spread rather uniformly among the higher deciles.

TABLE 1

COVERAGE RATIO DATA; BY SELECTED INDUSTRY GROUPS

Decile Number:	1	2	3	4	5	6	7	8	9	10	TOTAL
Percent of Gas Subject to Incremental Pricing: At Least:	0%	10	20	30	40	50	60	70	80	90	
But Less Than:	10%	20	30	40	50	60	70	80	90	100	
SIC 28 Chemicals No. of facilities (Percent of total)	382 (54.1)	27 (3.8)	26 (3.7)	36 (5.1)	35 (5.0)	30 (4.2)	39 (5.5)	35 (5.0)	41 (5.8)	55 (7.8)	706 (100)
SIC 29 Petroleum No. of facilities (Percent of total)	59 (25.1)	17 (7.2)	21 (8.9)	15 (6.4)	12 (5.1)	14 (6.0)	18 (7.7)	22 (9.4)	20 (8.5)	37 (15.7)	235 (100)
SIC 32 Stone, Clay & Glass No. of facilities (Percent of total)	131 (15.0)	56 (6.4)	60 (6.9)	59 (6.8)	58 (6.7)	92 (10.6)	85 (9.8)	115 (13.2)	132 (15.2)	83 (9.5)	871 (100)
SIC 33 Primary Metals No. of facilities (Percent of total)	297 (42.1)	47 (6.7)	36 (5.1)	42 (6.0)	34 (4.8)	38 (5.4)	32 (4.5)	43 (6.1)	51 (7.2)	85 (12.1)	705 (100)
TOTAL	869 (34.5)	147 (5.8)	143 (5.7)	152 (6.0)	139 (5.5)	174 (6.9)	174 (6.9)	215 (8.5)	244 (9.7)	260 (10.3)	2,517 (100)

The stone, clay, and glass industries display a different, more bell-shaped, size distribution. Only about 15 percent fall into the lowest decile. The highest decile contains less than 10 percent of the total. A large number of facilities fall in the seventh and eighth deciles; about 28 percent of all facilities are subject to average surcharges of between 42 cents and 54 cents per Mcf.

The data on the primary metals industry reveals a more uniform pattern. The lowest decile contains 42 percent of the total. The highest contains 12 percent.

In an effort to more fully assess the impact of the small use exemption, EIA-50 data was also used to estimate average daily gas consumption on a year-round basis. Facilities were then grouped into categories consuming less than 100 Mcf per day, between 100 and 200, and so forth (see Table 2). The grouping is of course only approximate, since a more accurate computation would require detailed seasonal use profiles, which are not available.

This simplified estimate of average daily consumption reveals an apperently large number of relatively small facilities -- particularly in the chemical industry. Over 60 percent of the facilities in the chemical industry use less than 100 Mcf per day average use on a year-around basis. Another seven percent used between 100 Mcf per day and 200 Mcf per day. Ignoring the effect of seasonal variations, these small facilities would not be exposed to incremental pricing under either the small use exemption or through operation of an exemption similar to that

TABLE 2

AVERAGE GAS CONSUMPTION; BY SELECTED INDUSTRY GROUPS

Category Number:	1	2	3	4	5	6	7	8	9	10	TOTAL
Average Daily Gas Use (Mcf) At Least: But Less Than:	0 100	100 200	200 300	300 600	600 1200	1200 2400	2400 3600	3600 7200	7200 10,000	10,000+	
SIC 28 Chemicals No. of facilities (Percent of total)	439 (62.2)	50 (7.1)	28 (4.0)	54 (7.6)	45 (6.4)	35 (5.0)	17 (2.4)	19 (2.7)	7 (1.0)	12 (1.7)	706 (100)
SIC 29 Petroleum No. of facilities (Percent of total)	93 (39.6)	25 (10.6)	9 (3.8)	26 (11.1)	28 (11.9)	18 (7.7)	9 (3.8)	14 (6.0)	6 (2.6)	7 (3.0)	235 (100)
SIC 32 Stone, Clay & Glass No. of facilities (Percent of total)	232 (26.6)	97 (11.1)	51 (5.9)	141 (16.2)	141 (16.2)	118 (13.5)	44 (5.1)	39 (4.5)	6 (0.7)	2 (0.2)	871 (100)
SIC 33 Primary Metals No. of facilities (Percent of total)	370 (52.5)	56 (7.9)	33 (4.7)	68 (9.6)	46 (6.5)	42 (6.0)	26 (3.7)	29 (4.1)	16 (2.3)	19 (2.7)	705 (100)
TOTAL	1134 (45.1)	228 (9.1)	121 (4.8)	289 (11.5)	260 (10.3)	213 (8.5)	96 (3.8)	101 (4.0)	35 (1.4)	40 (1.6)	2,517 (100)

applicable to small boiler use. Considering all of the four major SIC codes, fully 1,483 facilities, or 59 percent of the 2,517 studied, used less than an average of 300 Mcf per day and would be exempt from incremental pricing.

A review of the coverage ratio data gives rise to a very different interpretation, however. Although 1,483 facilities fell into the lowest three average use categories (less than 300 Mcf per day), only 869 facilities fell into the lowest coverage ratio (less than 0.1). Clearly, a facility using no more than 300 Mcf on any day would have no exposure to incremental pricing and thus would have a coverage ratio of zero. The fact that many facilities using less than 300 Mcf per day on an annual average basis have coverage ratios in excess of 0.1 indicates the considerable degree of seasonality in gas use patterns.

If a small use exemption similar to that applicable to boiler use were adopted in lieu of the "first 300 Mcf per day" rule, many facilities whose annual average use is below 300 Mcf per day would be caught by the program due to high seasonal use. It is likely that many of these small facilities would switch to alternative fuels when their average use in any month threatened to trigger the general application of incremental pricing. For non-boiler use, the alternative fuels most likely to be used in many industries are distillate oil and propane. In some situations, an alternative fuel may not be available or practicable, and temporary shutdown may represent a less expensive alternative than subjecting all gas use to incremental pricing. Temporary shutdowns and the use of scarce and expensive alternative fuels are both economic "waste" which will be avoided by exempting the first 300 Mcf per day of average use for all users subject to Phase II.

About one quarter of all facilities studied (614 facilities) have annual average use below 300 Mcf per day, but would be subject to incremental pricing under the originally-proposed "all or nothing" small user rule due to seasonality considerations. Significantly, at least 90 percent of the gas used by these facilities will be exempt under the small use exemption adopted by the Commission. Another 260 facilities (10.3 percent of the total studied) had annual average use of between 300 and 600 Mcf per day. Many such facilities would also find supplemental use of expensive alternative fuels economically advantageous under an "all or nothing" rule, but will not be penalized for using more attractive natural gas under the treatment adopted.

Having isolated the general effects of the small user exemption, the other potentially significant influence on Phase II coverage is the statutory exemption for agricultural uses. The analysis of the small use exemption and the agricultural exemption may then be incorporated into a broader study of the entire Phase II program. An estimate of the total quantity of gas subject to surcharge, total surcharge dollars, and the resulting rate decrease for exempt users may be developed. For the four SIC codes considered above, the magnitude of the agricultural exemption must be estimated.

The petroleum and primary metals industries are generally unaffected by the agricultural exemption, and all non-boiler gas in excess of the small use exemption can be assumed subject to Phase II. About 40 percent of the non-boiler gas consumed in the chemical industry is estimated to be eligible for exemption as agricultural. This exempt gas includes nearly all of the feedstock consumption in the chemical industry since agricultural ammonia is the principal product. In the stone, clay, and glass industries (SIC-32), 15.5 percent of all gas consumption is in the production of sanitary food containers -- glass jars and bottles. Since 95 percent of gas use in SIC 32 is non-boiler, the 15.5 percent agricultural exemption can be applied to non-boiler use directly with little loss of accuracy. After all appropriate adjustments for boiler use, small use exemptions, and agricultural exemptions, 839,578,954 Mcf, were estimated to be subject to Phase II in SIC's 28, 29, 32 and 33, on the basis of the most recent EIA-50 data.

In manufacturing industries other than the four considered above, a total of 573,320,854 Mcf was reported consumed. Of this quantity, 68.75 percent, or 394,158,087 Mcf is estimated to be non-boiler use. Agricultural use in SIC's 2141 (tobacco), 3411 and 3497 (fabricated metal food containers) reduce the total somewhat more. Finally, the small use exemption profile developed for the four industry groups is estimated to be equally applicable to other non-boiler uses, so that 80 percent of the remaining gas will be subject to surcharges. The total quantity estimated to be subject to Phase II in other manufacturing industries is 308,314,412 Mcf.

One more step remains before the total impact of Phase II can be assessed. Some gas consumption in SIC codes 22 (textiles) and 26 (pulp and paper) will be subject to Phase II. Most, but not all, gas used in these industries will qualify for the agricultural exemption. Estimates of the fraction of gas use which is not so exempt were derived from data developed for the Environmental Assessment. The effect of the small use exemption was assumed to be 20 percent, consistent with other manufacturing industries. The baseline consumption data was taken from the most recent EIA-50 reports, adjusted to remove intrastate gas use. In summary, 15,271,982 Mcf of gas subject to Phase II was found in SIC codes 22 and 26. All gas consumed in SIC code 20 (food) was considered to be exempt.

No attempt has been made to explicitly estimate the volume of gas that may be exempted from incremental pricing by reason of cogeneration. This is because the cogeneration exemption is expected to have a negligible effect on the scope of the Phase II program. The great majority of both existing and proposed cogeneration facilities are steam turbine topping-cycles. Such steam-raising facilities would be subject to incremental pricing under Phase I, if not exempted. Only bottoming-cycle cogeneration facilities and unusual topping-cycle facilities in which high temperature combustion turbine or engine exhaust is used directly for process heat would be potentially subject to Phase II. Widespread application of such facilities is not expected in the near future.

Mr. DINGELL. The Chair recognizes first my good friend from Ohio, Mr. Brown, and then I will recognize the sponsor of the resolution we will be considering, Mr. Sharp.

Mr. BROWN. Thank you, Mr. Chairman.

At the outset of today's consideration of FERC's phase II incremental pricing submittal, I want to congratulate you on the speed with which you have scheduled subcommittee consideration, Mr. Chairman, of this most important issue. If only we could arrange to have you schedule a markup on repeal of title II of the Natural Gas Policy Act in as quick a manner, then I would consider it quite an accomplishment.

Mr. DINGELL. We shall do that when we get around to it.

Mr. BROWN. I knew that you would do it with all deliberate speed, Mr. Chairman.

Before we hear from Chairman Curtis and the other FERC Commissioners regarding their phase II submittal, I want to personally thank each one of them for the efforts they have put in to what was obviously an impossible task. That is, coming up with a rational, workable phase II incremental pricing program consistent with the objectives of title II of the Natural Gas Policy Act.

I wish to also thank the Commissioners for their honesty in pointing out the problems with the entire concept of incremental pricing. I think the work has been done with a quality of statesmanship and responsibility that I want to commend, and commend quite seriously.

Mr. Chairman, as you have well stated on numerous occasions, incremental pricing was designed with two goals in mind—the first was to serve as a market ordering device designed to achieve an orderly transition from regulated to deregulated gas markets. Second, incremental pricing was to serve as a mechanism to shelter the consumer from increased natural gas prices. It is now apparent that rule 2 will satisfy neither one of these objectives. As the Commission has stated itself in the rule, the structure of title II makes it impossible for incremental pricing to act as a market ordering device. The major reason that incremental pricing will not serve to restrain pipeline bidding for deregulated gas is that industrial end users who have little or no capability to switch to alternative fuels—that is most feedstock, and process gas users—the users covered by this rule before us are in a relatively weak position in bargaining with pipelines over the price they will pay for natural gas.

That is, where an industrial user does not have alternate fuel capacity there is little or no incentive on the part of the pipelines to keep its bids for natural gas down.

The second objective of incremental pricing, protection of the residential gas consumer also will not be served by this rule. Incremental pricing singles out less than one-half of all residential consumers, those served by interstate natural gas pipelines. Those residential users who do not use natural gas but who use fuel oil, propane, electricity, or other fuel instead of gas, will receive none of the benefit that will result from incremental pricing of natural gas. Yet, under rule 2, these residential users would have to bear the higher costs for industrial goods that result from incremental users paying incremental service charges. Thus, all consumers would pay higher prices for goods and services in order that a few residential interstate natural gas consumers get what is at best a slight reduction in their gas bills.

Low-income non-gas users will in part be subsidizing more affluent gas users, and homeowners who do not use natural gas, will subsidize gas used by other high-priority users, such as small commercial establishments and apartment buildings, which are exempt from incremental pricing.

In short, incremental pricing has disruptive and inequitable impacts which will work ultimately to the disadvantage of the high-priority consumers, whom title II is intended to protect.

While I think you have done a good job, I do not think it is a job that it is possible to do well enough to make it worthwhile.

Mr. Chairman, in my view, incremental pricing is a concept that is inherently inequitable and unworkable. Because we have this opportunity to disapprove of the major part of the incremental pricing program , I urge my colleagues to vote for the resolution of disapproval which will be considered immediately after we conclude this hearing, as I understand.

Mr. DINGELL. At this time I would like, without objection, to insert in the record an article from the Energy User News that is relevant to our hearing on April 3.

[The article referred to follows:]

[From the Energy User News, Apr. 14, 1980]

FIRMS EMPTY RESID TANKS, USE LESS GAS

(By John Schneidawind)

NEW YORK.—While incremental pricing has been blamed for a trend among industrial firms to choose burning oil or coal over natural gas, it is not the only factor prompting the switch.

A continuing decline in the price of residual fuels and the cost of carrying fuel not used over the unusually mild winter have caused companies to either buy resid at depressed prices or attempt to use up excess resid to reduce inventory costs.

Last week, an EUN spot survey indicated that a number of industrial firms had stopped burning gas because the Federal Energy Regulatory Commission's monthly alternate fuel price ceilings had permitted gas to become more expensive than an equivalent amount of fuel oil (see April 7 EUN, page one).

But other firms dispute the results of an American Gas Association (AGA) survey presented two weeks ago before the Energy and Power subcommittee of the House Commerce Committee which listed 18 industrials (including Firestone, Goodyear, and Ford Motor Co.) that had supposedly switched from gas to No. 6 oil because of incremental pricing.

The AGA sought to use the results to prove that incremental pricing, (a government program designed to shield residential consumers from the cost of new and decontrolled gas by directing its impact to industry) would cause such a drop in industrial gas consumption that residential customers would wind up paying more for gas anyway. AGA now admits that the list was preliminary and subject to change.

According to J. R. Maroni, environmental research and energy planning director for the Ford Motor Co., the AGA reference to Ford's switch to No. 6 is to a "spot purchase of No. 6 oil at distressed prices by a Twin Cities, Minn. plant."

"Surplus resid resulting from a mild winter in the northern Midwest which was very expensive (for a supplier) to carry over at the present high interest rates was offered at prices well below the FERC incremental price ceiling, and in some cases below the exempt interruptible boiler rate," said Maroni.

"We wish to point out that the Ford use of the oil in question had very little to do with incremental pricing and to correct any impression that Ford is a member of one of the user groups lobbying for repeal of the incremental pricing provision of the NGPA," he added.

"The resid that we bought," said Maroni "was not only lower than the incrementally priced gas, it was lower than any gas we could buy."

MARKET PHENOMENON

Maroni's reference to "carrying over" oil at high interest rates highlights a market phenomenon facing both buyers and sellers of oil or gas. In some cases, industry has switched from gas simply to use up significant volumes of resid bought late last summer in preparation for a cold winter and gas curtailments.

When that cold winter never materialized, many firms were left with quantities of resid bought at high prices with money borrowed at high interests rates, sometimes as high as 18 to 20 percent.

Rather than continue purchasing patterns which normally see industry using up oil bought for winter use and then switching to gas in warmer months, many firms have opted to stop using gas altogethr and move to burning oil. This strategy is being followed or may be followed by two industries particularly affected by the downturn in the economy—tire and automobile manufacturers.

One company that has stopped using natural gas and is using up its fuel oil is the Armstrong Tire & Rubber Co., Des Moines. According to general manager Dick Twickler, such a corporate strategy is mandated not only by the price of oil or natural gas, but by the general downturn in the economy which has seen less tire products sold this year than in previous years. This result in a buildup in inventories of finished goods, process goods (partially finished products), and raw materials, he said.

In Armstrong's case, says Twickler, "when earnings have been down, you have to start looking closely at where you can cut costs."

INVENTORY REDUCTION

Armstrong thought that prices of resid would continue to increase or at least remain stable, enabling them to sell any surplus resid on the open market at a profit. Now that the market for resid has collapsed, however, the firm is looking to reduce costs through reduction of inventory which includes one million gallons of No. 6 fuel oil.

Twickler estimates that the company will probably reduce its No. 6 stock to the 300, gallon level sometime this week, after which the firm will purchase No. 6 on a "buy it as you need it" basis.

So, did Armstrong stop using natural gas solely because incremental pricing made it more expensive?

"No," says Twickler.

Maroni of Ford Motor Co. says that philosophy will not be followed by Ford, since the firm does not have significant quantities of fuel oil to worry about. "But a lot of firms are probably saying 'We don't want to carry this (oil) at 20 percent through the summer; let's burn it up.'"

Another firm that has switched to burning oil at one of its plants because of incremental pricing is Caterpillar Industrial Products Inc., Peoria, Ill. But, according to energy coordinator R. A. Staker, "There's not one reason to switch (fuels). Since the tractor industry has not been affected by the recession to the same extent other vehicle manufacturers have, the firm is not burning oil to reduce inventory costs.

Mr. Dingell. The Chair recognizes the gentleman from Indiana, Mr. Sharp, our colleague, for such comment or statement as he wishes to make.

Mr. **Sharp.** Thank you, Mr. Chairman. I do have some remarks that I will be glad to make at the time I advocate the resolution of disapproval. However, I would be delighted to hear what the Commission has to say about the rule before we make that judgment. So, it strikes me, we might proceed in that manner.

Mr. **Dingell.** Members of the Commission, we thank you for being with us. Mr. Chairman, we will now recognize you, and after that we will recognize each of your associates in such order as they desire to be recognized.

If you would, just for purposes of the record, introduce yourself, Mr. Chairman, and also your very able associates who very graciously have joined you at the table.

STATEMENT OF CHARLES B. CURTIS, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION, DEPARTMENT OF ENERGY, ACCOMPANIED BY GEORGE HALL, GEORGIANA SHELDON, AND MATTHEW HOLDEN, JR., COMMISSIONERS

Mr. **Curtis.** Thank you, Mr. Chairman.

On my immediate right is Commissioner George Hall, who has assumed the very difficult task of providing direction and leadership to the development of the Commission's implementation of the incremental pricing requirements of title II. While Commissioner Hall has assumed that responsibility on our behalf, the decisions on incremental pricing are collegial in character, of course, and made by the entirety of the Commission. It is for that reason, primarily that I thought it most appropriate for the entire Commission appear before the Congress today to discuss this matter.

On Commissioner Hall's right and my far right, is Commissioner Georgiana Sheldon, and on my immediate left Commissioner Matthew Holden.

Mr. Chairman, I have a formal statement. It is short, but I would—even in light of its brevity—simply ask that it be placed in the record as if read, rather than belabor the subcommittee's time with it.

Mr. **Dingell.** I think that makes admirable good sense. Without objection, so ordered. [See p. 368.]

Mr. **Curtis.** I think, Mr. Chairman, that your opening remarks and those of Congressman Brown have cast the issue properly before the subcommittee. There were essentially two perceived congressional objectives in fostering the title II requirements. The Commission viewed it as our task to fashion a rule under phase II, which to the maximum extent practicable—given our administrative judgment—carries out those perceived congressional objectives. The two are the market ordering objective which both you and Congressman Brown have discussed, and the residential price sheltering objective.

We do not find that an extension of incremental pricing beyond industrial boiler-fuel users, who are covered under phase I, would effectively accomplish the congressional purpose to order the marketplace in preparation for decontrol.

We do, however, believe that the price-sheltering benefits which the Congress in 1978 perceived as appropriate could be accomplished. We have prepared, therefore, and submitted for your consideration a rule which does—given due consideration to the burdens on industry—achieve some measure of price shelter for residential users, schools, hospitals, and agricultural users—those that are within the statutory confines of priority users.

Whether this rule should take effect is a social judgment that the Congress has reserved to itself through the congressional review mechanism. This reservation allows Congress to examine market circumstances as they exist today, and to determine whether the goals which we find embodied in title II, particularly with regard to phase II, are still appropriate and should go forward.

I believe, and I think my colleagues share my belief, that the Congress is the proper forum for making that judgment, not the Commission, which can be expected to be expert in terms of the management of the gas market and its mechanisms, but not in making those fundamental political judgments that appear to underlie the congressional purpose in phase II. The Commission is fully prepared for the Congress to exercise its judgment on this matter.

Individual members of the Commission all have personal views on some of these matters. It is my personal view that the potential for disruption and for serious distributive problems in the 1984-85 period is very significant, and that a mechanism does need to be developed which will give greater assurance that market forces can effectively and efficiently substitute for a system of governmental controls. In my opinion, if decontrol is to occur, Congress must conscientiously address the significant distributive problems which the poor and the low income are going to have in managing a rapid and very substantial price increase in 1985 if the markets perform the way that we think they are going to perform on the basis of our analysis today.

We find that incremental pricing is a blunt instrument which is not very effective in accomplishing either the market ordering purpose or the price sheltering purpose. That does not mean that these are not real concerns or that the Congress should fail to address them. I believe they must be addressed, but they must be addressed through mechanisms that are more refined and more appropriate to the task than the tools with which you have equipped the Commission.

With that, Mr. Chairman, I would yield to any statements that my colleagues might wish to add, if that would be your pleasure.

[Testimony resumes on p. 373.]

[Mr. Curtis' prepared statement follows:]

Statement of
Charles B. Curtis
Chairman, Federal Energy Regulatory Commission
before the
Subcommittee on Energy and Power
of the
Committee on Interstate and Foreign Commerce
House of Representatives

May 6, 1980

Mr. Chairman and members of the Subcommittee, my colleagues and I are here today to discuss with you the Federal Energy Regulatory Commission's regulations implementing Phase II of the incremental pricing program required by Title II of the Natural Gas Policy Act of 1978 (NGPA).

This rule proposes a broadening of the scope of the incremental pricing program. Let me say at the outset that the Commission has come to this assignment with the view that we have been asked to bring our technical expertise to bear on the design of a workable Phase II rule that best advances the purposes underlying incremental pricing.

In our Phase II order, we have attempted to provide the Congress with our best assessment of the relative costs and benefits of expanding the incremental pricing program. But the Commission believes that the fundamental evaluation of any Phase II rule is one that the Congress has expressly and properly reserved to itself. The judgment as to whether this Phase II rule will achieve the social goals set out by the Congress and, indeed, whether these goals are still appropriate, is one that the Congress and the Congress alone should make.

Before I describe these rules in further detail, I would like to talk about my understanding of the social and economic purposes underlying the NGPA and the incremental pricing provisions.

The NGPA is the product of compromise. On the one hand, there were those who felt that price controls on natural gas had discouraged exploration and development because gas was regarded as a public utility service and not as a "commodity". This faction, which included most of American industry, claimed that, at least with respect to newly discovered gas, it would be best to leave prices to the market forces on which a private enterprise economy generally relies.

On the other hand, there were those who did not accept the premise that sharply higher prices would lead to commensurately sharp increases in supply and felt that natural gas is a finite, non-renewable resource which must be conserved. This faction felt that the only thing certain about deregulation is that it would shift enormous streams of income from consumers to producers; that the real flaw in the Natural Gas Act (NGA) was the fact that it created a pernicious dichotomy between the tightly regulated interstate market and the largely unregulated intrastate market, and that the cure for that was extension of regulation to the intrastate market.

In 1978, the Congress compromised and extended regulatory controls to the intrastate market as a transitional measure, while deciding to deregulate in phases.

Everybody knew that deregulation (however gradual) would make gas more expensive -- both during the transition and after 1985, when most gas would be sold at free market prices. The Congress was concerned about the equitable allocation of those additional gas costs.

The Congress decided that it would be in the public interest to place more than the pro rata share of that burden on industrial users of gas. That would shield the residential consumer from the full impact of higher gas prices.

Incremental pricing also has another conceptual basis. This is the market-ordering idea. As I see it, this idea rests on certain judgments about the natural gas market, which I'll attempt to describe.

Market forces in a deregulated environment will value domestic natural gas in relation to some alternative energy source. The primary alternative is oil which is priced considerably above the cost based prices previously allowed under the Natural Gas Act and indeed considerably above the price path set out in the NGPA.

Consequently, gas could rise sharply and abruptly in 1985 when significant quantities of gas are to be decontrolled. The potential exists at that time, therefore, for an enormous transfer of wealth from gas consumers to gas producers. Hence, the Congress searched for some sort of a constraint that would act as a brake on prices. It was thought that incremental pricing would serve this purpose because price-sensitive industrial customers would already be paying at or quite near the price of their alternative fuel. It would not take much to push these industrial users above the line precipitating a switch to other fuels. The threat of industrial load loss, it was reasoned, would cause pipelines to watch their gas costs and would discourage aggressive competitive bidding for gas.

Thus, we have two quite different foundations to incremental pricing. One views incremental pricing as an equitable program grounded on social judgments that industry should bear a greater share of the burden of increased costs for the the most precious of our fossil fuels. The other views incremental pricing as a force countervailing average cost pricing in order to improve the performance of the markets so as to allow market forces to effectively substitute for a system of government price controls.

Our task in designing a Phase II rule to give effect to these objectives reflects our tentative conclusion that the so-called market ordering purpose will not be served by extending the incremental pricing program. At present, the Commission does not believe that its discretion to set appropriate alternative fuel ceiling prices is a sufficiently broad grant of authority to allow ceiling prices higher than actual fuel prices, thus removing the threat of industrial load loss which was to restrain pipeline bids. This "cap problem" arises from a statutory construction that sets industrial gas prices up to, but no higher than, the price of alternative fuel oil. The ceiling prices may instead have the effect of shielding industrial users from the very disorder they are supposed to help cure, and deflecting rising gas costs onto exempt high priority users who were to be protected.

However, we did find that an extension of incremental pricing would further the Congressional purpose in sheltering high priority users from some of the impact of increased gas costs. Hence, we are submitting to the Congress a rule which will extend incremental pricing to all industrial facilities that do not have statutory exemptions. We chose a broad scope for the rule because: (1) this maximizes the potential to shelter high priority users and (2) we could not find any satisfactory basis for exempting one industry group from another, to distinguish the social value of one industry as higher or more important than the social value of another.

The Congress should seriously consider the following issues and questions in deciding whether to go forward with Phase II of incremental pricing.

On the one hand, Congress should consider:

* Because of its characteristics, natural gas is considered to be our most valuable fossil fuel.

* The high-sulphur No. 6 oil price represents the minimum commodity value of this precious fuel. Pricing policies which fail to reflect this minimum commodity value tend to encourage waste and subsidize imports.

- * The No. 6. high-sulphur residual fuel oil price most recently published for the month of April is less than the marginal supply price for most major interstate pipelines. More than 10% of major interstate pipeline supply is acquired at price levels which are equal to or exceed the delivered price of gas to industry.
- * If industry encounters significant problems remaining profitable when natural gas prices are set on a par with the high-sulphur resid, a defeat of Phase II may simply postpone the problem, not cure it.
- * On the other hand, to the extent that the problems are merely transitional, and I suspect most are, the question arises whether industry isn't better able to manage the distributive difficulties presented by rapid increases in energy prices than are residential users, inasmuch as industry at least has the potential ability to pass these increased fuel costs on in the form of higher prices for goods and services.
- * With respect to the concerns over the inflationary impacts of incremental pricing, to the extent that industry is unable to pass through these costs, the result of incremental pricing may be anti-inflationary (albeit perhaps recessionary) in its ultimate impact.

On the other side of the ledger, one might consider these factors:

- * Although the purchased gas costs of interstate pipelines increased by almost 50% from August 1978 to August 1979, prices to residential customers served by local distribution companies feeding off of interstate pipelines increased only 15%, running only slightly ahead of the general rate of inflation. Do residential users in such circumstances really have an equitable claim to shelter from these impacts?

- If the real significant price impacts under the Natural Gas Policy Act are likely to occur in 1985, shouldn't the program be deferred until a time closer to that date? Inasmuch as the burdens of incremental pricing must be carried by industrial users accounting for only 15% of interstate consumption while the benefits are distributed over the other 85% of the load, aren't the benefits spread so thin as to be relatively insignificant as compared to the burdens allocated to industrial facilities? Given the prospects of a general downturn in the economy, why risk adding to recessionary pressures for so small an individual benefit?

I am not really prepared to suggest the answers to these questions. Obviously, much of this turns on fundamental questions of judgment and policy. They are political judgments — the grist of the legislative mill. But I would suggest that the answers are not straightforward. It is, to me, a difficult riddle whether to go forward with Phase II or not. That, as I have said before, is clearly a decision which the Congress has reserved for itself. For my part, I think it is well committed to Congressional judgment.

Thank you.

Mr. DINGELL. Lady and gentlemen, if you have comments that you would like to make at this point, we would be honored to receive them.

Mr. HALL. I concur with the chairman on his position.

Mr. DINGELL. Commissioner Holden?

Mr. HOLDEN. Mr. Chairman, I have absolutely nothing to add to the chairman's statement except to take the opportunity to say that I would concur with particular emphasis on the last part of his statement about the distributive question. I would emphasize that rather strongly. But the substance of his entire statement I would share entirely.

Mr. DINGELL. Commissioner Sheldon?

Ms. SHELDON. I agree with my colleagues. I did have some philosophical differences, perhaps, with the legislation. But I did take the mandate of the Congress seriously and voted for the final rule to come to the Congress.

I believe I would have to say that unless the Congress mandated the Commission to do so, I would not vote in favor of returning this particular rule or a similar one to the Congress after the 6-month period has passed.

Mr. DINGELL. Commissioners, we thank you also for your kindness. The Chair again commends the Commission for having so speedily and expeditiously met the deadlines fixed by the Congress and complied fully, I believe, not only with the spirit but the letter of the law in its Phase II decision. You have the appreciation of the Congress for the expeditious, careful, and thorough way in which you have carried out the mandate which was laid upon you by the Congress.

The Chair does concur, I observe, in your concerns with the possibilities that exist with regard to a disorderly market as we approach the 1985 deregulation date. Given that set of circumstances, your comments about the need to have an adequate mechanism for market ordering are very appropriate. That could be done, as you have observed, Mr. Chairman, through the mechanism of incremental pricing. But you make it clear, I believe, that we would need some additional mechanism. Am I correct on that?

Mr. CURTIS. Yes, sir. It can most effectively be done through retail rate design modification, a mechanism which is regulated under State rather than Federal authority. Let me be quick to point out that I am not asking for that authority.

I am only suggesting that a much more refined way of addressing these concerns and making the economic and social balances involved, is through State action that may be guided by concerns at the Federal level. I do not wish the subcommittee to think I even suggest that the Commission be equipped with authority to exercise mandatory controls with respect to retail rate design. I just do not think we could exercise it intelligently.

Mr. DINGELL. If the market is disorderly as we approach 1985, the only mechanism which would be available would be incremental pricing, if it is there; or in the alternative, the reimposition of controls which the President can engage in for a brief period of time under the Natural Gas Policy Act; is that correct?

Mr. CURTIS. It appears to me on the basis of what we know today that there exists a considerable potential for a "spiking" or a flyup effect of prices in 1984 as we go through the transition in 1985 to decontrol. That potential is one discussed in the preamble materials of the Phase II rulemaking. The best analysis that we have been able to pull together on that suggests that there could be a substantial transfer of wealth from consumers to producers at that point because there would still exist a considerable amount of gas under price controls and under price restraining contracts.

A cushion capability has been valued somewhere around $40 billion in 1985. If that cushion is spent in aggressive, competitive bidding for available deregulated supplies, it would result in a transfer of that some $40 billion to producers at that point. I am concerned that the market mechanisms will not effectively substitute, then, for governmental controls. It is a concern that I think the Congress properly had in 1978 and should have today.

Now, whether this spiking of prices in fact occurs is something that we may all have to wait and see as the markets shape out and shake out in the next couple of years. There are those who maintain that the spike effect will not be anywhere near the dimension that some analysis seems to suggest. They may be right. Our best judgment at this point is that they are wrong and that the potential for sudden large price increases are substantial. Some mechanism will have to be in place to assure that an orderly transition to deregulation can in fact occur at that time.

Mr. DINGELL. Do any of the members of the Commission have any comments on the points you and I have been discussing? Mr. Holden, Mr. Hall, Ms. Sheldon?

Mr. HALL. I agree.

Mr. DINGELL. Well, I express again to all of you the thanks of the subcommittee. The Chair will recognize my colleagues now in order of their appearance. The Chair is going to recognize first my colleague from Indiana, Mr. Sharp.

Mr. SHARP. Thank you very much, Mr. Chairman. I, too, want to join in your remarks complimenting the Commission and its Chairman on their effort to carry out as they assess it, the will of Congress and to judiciously address the problems that come before the Commission, and to meet the deadlines that have been set by Congress—whether they are realistic or not. I appreciate that fact. Too often we in Congress are making allegations that various agencies do not follow the will of the Congress—sometimes people may think that is actually wise, but I appreciate the fact that you people take very seriously your constitutional and legal mandate.

I am concerned, as you are well aware, with the impact of the rule 2 pricing, and I just have a couple of questions in addition to the previous hearing that we had. One which really relates to rule 1 is the cap problem which, if rule 2 survives, would apply to it as well, and the difficulty of providing some consistency in the pricing and some real world price cap level.

If I understand the testimony from some of the industrial users and some of the gas distributing pipelines and companies is that there is a real problem in one—at least from their perspective a real problem—that the price bounces around and it may or may not reflect what is the real world of price, the price that you people set as the alternative cap may not reflect the real world price that they actually would deal with.

I wondered what your sense is about your ability to further refine the cap.

Mr. HALL. Thank you. I would like to respond to that if I may, Mr. Sharp.

With regard to the cap, I think there is a need to further refine the techniques that are used to collect the data on the No. 6 high sulfur residual fuel oil as they apply in the market, and the Energy Information Administration and the FERC are working on that. I hope that we will have some improvements in the collection techniques.

However, I think what is important here is that we are trying to determine a price which is sufficiently low enough as to represent a floor price—not the average price that applies in an area—but some price which represents a lower level.

We are also going to have seasonal swings in oil prices. There is no way, no practical way in which the statistical tracking mechanism can be absolutely up-to-the-day current, particularly when you run into a situation as we have encountered this spring, in which the ordinary seasonal downturn for residual fuel oil appears to have been exacerbated by unusual softness in the market. There will be a dip that the statistical reporting technique will not pick up for a short period of time. I think that is just unavoidable. We will try to minimize that lag, but there will be a lag.

So, my basic answer to your question is that the technique does need refinement. We knew at the time we passed the phase I rule that there would be a process of developing the statistical techniques and we made provision for that. One reason we went to a mean minus two standard deviations level was to allow sufficient room for adjustment for the developmental period.

Mr. **Sharp**. Well, is it your understanding that the high sulfur No. 6 was unusually volatile earlier this year than it normally would be, and hopefully the market place in oil may in a sense help resolve that question; or is that something that is in the history of it and therefore we could expect to continue?

Mr. **Hall**. Well, I think it was unusually volatile this year. However, about this time of year you do usually get a downturn in the residual fuel oil market as the stocks built up for the end of the winter are put on the market.

Mr. **Sharp**. Well, I wonder if there might be another approach you might take, I am not sure you have it, and you people have addressed this more carefully than I have, or I suspect any of us on the subcommittee. But it strikes me that you might be within the law, that your problem is just to make sure that you are below the alternative fuel price ceiling. I am not sure that requires you, therefore, to choose the alternative price ceiling. Do you understand what I am saying? Do you necessarily have to link the cap to the price ceiling, the alternative price ceiling, or could you administratively set some different guideline, just as long as on the average it stayed below the cap?

I do not know that would resolve the problem, but it strikes me there may be an alternative that the law would allow you to use, rather than pegging it—on a monthly basis, is that what it is—to that.

But, I guess some question has been raised about your legal ability, how much discretion you have. I would hope you would see the intent being rather discretionary in that area.

I see the chairman is after me, so I will withhold my other question. Thank you, Mr. Chairman.

Mr. **Dingell**. The time of the gentleman has expired. The Chair recognizes now the gentleman from Ohio, Mr. Brown.

Mr. **Brown**. Thank you, Mr. Chairman.

Mr. Curtis, members of the Commission, the whole situation puts me in mind of a little homily that my mother used to tell me when I was younger—if she were still here, she would certainly recite it to me very regularly, given the line of work I am in. It goes, "Oh, what a web we weave when first we practice to deceive." In this case the deception is an effort to deceive the market, or fool around with mother nature, to use a popular commercial.

The spike that you are talking about in 1985–87 will result from the price increase mechanism now built into the Natural Gas Policy Act being too gradual to represent what the market really is. I think you are going to face probably one of four choices in 1985–87, either deregulation on an EPAA schedule to increase the tilt somewhat earlier to get to world comparable Btu prices more gradually; or else deregulation of kinds of gas in these 20 categories that we have, on a step-by-step basis, which would have the same effect of gradually achieving a market price. Or else, another incremental pricing rule which would distribute it in some odd way through the market so that it does not fall all at once on somebody. Or recontrol.

Now, given that kind of situation, do you think, Mr. Chairman or members of the Commission, that title II of the Natural Gas Policy Act really is capable of being administered in a manner which could achieve the purposes which Congress intended that incremental pricing achieve, that is equity for the various users and an effort to mask for small consumers the price impact that you are going to face down the road?

Mr. CURTIS. Mr. Brown, title II, of course, has a mandatory part, and that is to impose incremental pricing on industrial boiler fuel users. There, I think, the mechanism has a greater opportunity to achieve the so-called market ordering purpose than is presented in the phase II side of that question.

Also, some shelter to the high priority users will result by an assignment of a greater proportional share of responsibility for high purchase gas cost to industrial users.

So, to the extent that those are the congressional objectives, phase I can further those objectives. I do not think that incremental pricing, either in phase I or as a general authority can accomplish the congressional objectives; nor do I think that it presents the most effective tools for addressing those concerns. But they are the only tools we have at present.

I would hope that the Congress could find substitute means for addressing these perceived problems.

Mr. BROWN. If you can think of any substitute means beyond those which I suggested, I would be happy to hear them. They were, again, to deregulate on the EPAA kind of schedule, tilt the pricing up to deregulate various kinds of gas, which has the same impact. Incremental pricing is the other choice, or recontrol is the other choice. I happen to think that the last two are the worst, and that the second one is not all that good. I would like to see us go to something more gradual because I do not think that any reimposition of rule 2 under any circumstances would have any other effect than that for which it is criticized right now; that is, that ultimately it may cause the displacement of natural gas with oil or some other fuel. It fails, really, to shelter residential consumers under certain circumstances. It causes revenue and customer instability for gas utilities because it falls differently on different circumstances, competitive circumstances and others.

It seems to me it would be quite an administrative burden for you all, and it would infringe on State regulatory authority, too.

So, I cannot see how it can be administered in any way. Would it be the intention of the Commission to—and I would like to ask each of you to comment on it—to reimpose either this rule 2 or offer another rule 2 at the time that it is authorized but not required for you to do so under the NGPA?

Mr. CURTIS. Let me speak first and individually. We viewed it as our responsibility, a mandatory responsibility, to present to the Congress a phase II rulemaking by May 9 of this year. That, we have done. We also viewed the statute as reserving to the Congress the decision to permit the rule to take effect or to prevent the rule from taking effect following an evaluation of the current market circumstances.

Now, if the Congress determines in its assessment of the current market circumstances that the rule should not take effect and therefore vetoes it, the Commission has the discretionary authority to return a phase II rulemaking to the Congress at some later date. I think Commissioner Sheldon indicated in her opening remarks that if freed from the mandatory aspects of phase II, she would not exercise that discretion to return any further phase II rulemaking to the Congress.

I, for one, would like to reserve the authority, believing that if one is given discretion, one must evaluate the exercise of the discretion in the market circumstances as they evolve. If those market circumstances change, it may be appropriate to submit a rule back to the Congress. This rule or something different from this rule. I, for one, would like to reserve the judgment of whether to return the matter to the Congress as market circumstances evolve.

Mr. BROWN. The others may wish to respond, however.

Mr. DINGELL. The time of the gentleman has expired.

Mr. BROWN. If the other members would like to respond, I asked the question.

Mr. DINGELL. I think the gentleman is entitled to ask it. Do the other members of the Commission, the lady and gentlemen have any comments you would like to make?

Mr. HALL. Mr. Brown, my mind has been completely concentrated on May 9, and I would like to think about what the next step is after we find out the results of the congressional review.

Mr. HOLDEN. I think, Congressman, my answer is, I really have not given full consideration to what the next step might reasonably be, or under what circumstances.

Mr. BROWN. And we already have Ms. Sheldon's comments.

Ms. SHELDON. I do not think the market circumstances are going to change that much in the next 6 months. I would hope they do, but I do not think so.

Mr. BROWN. I thank the chairman.

Mr. DINGELL. The Chair next recognizes Mr. Shelby.

Mr. SHELBY. Thank you, Mr. Chairman.

I would like to pick up at the outset on what the gentleman from Ohio has said about deceiving the marketplace. In other words, I think he mentioned the word "deception." I think it goes to the very heart of this matter when you are talking about increments and your incremental pricing, whom are you really deceiving? I noticed in some of the testimony, the written testimony of the chairman, that you are talking about social judgments and so forth, and consumers. Is not industry in a sense a consumer? If you carry industry on as a consumer of so much natural gas, who pays for the natural gas, the pricing of it? All of us do because we are consumers. If it is a steel facility using the natural gas; if it is a fertilizer plant or whatever it is, are we not all consumers? I know, we are talking about a fiction. I know my friend from Ohio will mention this, but whom are we really deceiving? I have to say to the Commission, we are deceiving the American people.

Just like the fiction that we had so long before we had deregulation, we had not had it completely. Why—and I am getting to the question—why should we have incremental pricing at all? I was not a Member of Congress when this came about and I know why you are here today. Would it not be best to go ahead and bite the bullet? We are going to have to sooner or later. By 1985, is it not 1985 when the incremental pricing expires, am I correct on that?

Mr. CURTIS. No, incremental pricing is a permanent program. Price controls on between 40 to 60 percent of production will expire in 1985. The range of 40 to 60 percent depends on whose analysis you are looking at.

Mr. SHELBY. And whose analysis you are looking at, would that be yours, the Commission's, or that of somebody else?

Mr. CURTIS. The American Gas Association estimates that 40 percent of domestic gas production will be released from controls in 1985. The Department of Energy puts that estimate between 55 and 65 percent of domestic production. I think it is fair to say that these are best guesses at this point. No one has a claim to having the right answer.

Mr. SHELBY. Sure.

Mr. CURTIS. In our business, of course, more than any other we recognize that the consumer pays for everything, whether it is the products of American industry, the goods or services.

Mr. SHELBY. They pay for it.

Mr. CURTIS. They pay for it.

Mr. SHELBY. Or we pay for it.

Mr. CURTIS. That is right. "They is we," as Pogo used to observe, when considering who the enemy is.

Mr. SHELBY. We might as well use that term interchangeably.

Mr. CURTIS. That is right.

It is true that the consumer is required ultimately to bear the responsibility for all costs in our economy, but there are consumers who have different means available to avoid higher costs. For example, the elderly on fixed income, the poor and the low income have very little opportunity to avoid the increased cost of their residential home heating, save for their ability to become more efficient in that use. They have already become substantially efficient in that use.

Other consumers, industrial consumers, have better opportunities to avoid those costs because of their ability to pass those costs on to the market place in the prices of the goods and services that they manufacture. Now, those goods and services may not be fundamental to the consumer's needs. Therefore, the consumer, by refusing to pay the increased prices for goods and services, can more effectively avoid the cost.

I assume that is the reason why the Congress has distinguished industrial consumers from statutorily identified high priority consumers.

Mr. SHELBY. Hence the political fiction—and I use the word "political" to describe it—in other words, incremental pricing was done here in Congress, was it not?

Mr. CURTIS. Well, I think it is fair to say that incremental pricing, as denominated in title II, is not incremental pricing as an economist would understand that term; rather, it is a mechanism for assigning a specific portion of purchase gas cost to one class of consumers so as to benefit other classes.

Mr. SHELBY. At the expense of the other, right.

Thank you, Mr. Chairman.

Mr. Dingell. The time of the gentleman has expired. The Chair recognizes now our friend and colleague, Mr. Gore.

Mr. Corcoran. Thank you, Mr. Chairman.

Mr. Chairman, I want to say, I am a little bit perplexed by the tenor——

Mr. Dingell. The Chair apologizes, I recognize the gentleman from Tennessee, Mr. Gore.

Mr. Corcoran. I remain perplexed.

Mr. Gore. I will try to finish up very quickly.

Mr. Corcoran. There is no lack of confidence in my colleague.

Mr. Gore. Our names sound similar.

This is an interesting procedure that we are going through here today. I found it fascinating. It seems to me to resemble euthanasia.

We have all come together, members of the family and the doctors. The decision is whether or not to pull the plug. Now, we are told that the patient can survive, but it is very likely that brain death has already occurred.

Those who worked so long on the Natural Gas Act came to think of it as kind of a member of the family. It was here for months and years, and if you go back and look at the arguments that took place at that time it is quite interesting because quite a few people said, "Consumers, after all, will be protected by the incremental pricing sections in this bill. So, we should not be overly concerned about the impact of deregulation."

But, as I say, it looks like brain death may have already occurred, and the merciful course of action may be to avoid prolonging the suffering.

Let me just ask a couple of quick questions before we pull the plug.

I will not ask again the embarrassing question of whether you are going to submit another rule or not. I think it is clear that you made that decision, at least tacitly. Let me ask—after this rule is killed, will the price paid by industry be lower or higher than residential prices?

Mr. Curtis. That depends.

Mr. Gore. Well, in fact it will be significantly lower in most of the country, is that correct?

Mr. Curtis. My problem is with the "will". The delivered price to industry is today on an average considerably lower than the delivered price to residential users. The reason I answered that "it depends" is because it depends on what the State commissions do on retail rates. Some of those have already adjusted their rate designs so that the delivered price to industry is greater than residential delivered prices in some sections of the country.

Mr. Gore. Those are the minority of jurisdictions, are they not?

Mr. Curtis. That is certainly so.

Mr. Gore. Now, we talk about this whole constellation of issues as if there were a free market, when in fact a free market in gas is a particular kind of market. If you are a consumer of natural gas and you do not like the price that your supplier is charging, what is your recourse, Mr. Chairman?

Mr. **Curtis**. If you are a consumer of natural gas from a local distribution company, what can you do to resist the price that your supplier has agreed to pay for gas? Is that the question, Mr. Gore?

Mr. **Gore**. Yes.

Mr. **Curtis**. The answer is, very little.

Mr. **Gore**. Very little. So, let me quickly summarize, Mr. Chairman, by saying that customers are captive customers and as a result States have competed with one another in the field of industrial development by assuring industrial customers lower prices. This is a factor which I guess should have been taken into consideration.

But, I intend to put the patient out of his misery in support of Mr. Sharp's resolution. I appreciate the thoughtful manner in which you have proceeded, and I just wanted to note the irony over the long debate which occurred when this matter was discussed in the last Congress.

Thank you, Mr. Chairman.

Mr. **Dingell**. The time of the gentleman has expired. The Chair recognizes now the gentleman from Texas, Mr. Gramm.

Mr. **Gramm**. Thank you, Mr. Chairman.

I would like to thank Chairman Curtis and the other members of the Commission for their statements. I am always encouraged when I hear Chairman Curtis because it reinforces in my mind that there is some logic and knowledge within the bureaucracy. Most of the testimony I receive from the bureaucracy on the committees on which I serve convinces me otherwise.

Somebody handed out a sheet up here that gives the rationale for vetoing phase II. It is beautifully written; it is very logical, and the interesting thing is, every point for vetoing phase II is an equally good point for vetoing phase I.

So, I would like to just try to be brief and note the following thing. First of all, I am hoping that in the new Congress, the 97th Congress, we will have votes to get rid of phase I as well as vetoing phase II here.

The second point—and I would like to pose it in the form of a question, Chairman Curtis—is this: You talked about the problem with incremental pricing, and that is, we have poor people. Poor people have trouble paying their bills. But that is a poverty problem, that is not an energy problem.

Let me just assume, in asking this question, that we had a perfect world in which we could raise all our welfare payments; we could deal directly with the poverty problem by providing supplemental income. In terms of the income of our economy, in terms of job creation, economic growth, competitiveness on the world market, and rational allocation of resources, would we not be better off dealing with this problem of poverty with a poverty program, rather than trying to hide actual increases in the cost of acquisition and production through an incremental pricing system?

Mr. **Curtis**. Mr. Gramm, I would have to speak individually. I believe that the single greatest failing of energy policy is the failure to recognize the need for solving social problems through social programs rather than through energy policy initiatives. If we could effectively deal with those social problems as social problems and through social programs, rather than through energy pricing decisions, we could have both better social policy and better energy policy.

By mixing the two, one not only sends confused and improper signals to the marketplace, but one also deals ineffectively with the social problems that were perceived in the first place.

So, my personal view is that I would hope that the Congress can address this problem for what it is, simply, that some sectors of our society are less able to pay for the transition to the higher prices which reflect the true economic circumstances of the energy market as it exists today.

I do not think it is simply a problem for the poor. I think it is a problem for those with fixed incomes, the low-income groups and, transitionally for middle-income consumers as well. Incremental pricing is an economic tool and does not provide us with the kind of social solution that is needed for this kind of problem.

Mr. **Gramm**. Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. **Dingell**. The time of the gentleman has expired. The Chair recognizes now Mr. Corcoran.

Mr. **Corcoran**. Thank you, Mr. Chairman.

My surprise at the nature of the hearing is that I had expected that the Chairman and the Commissioners would be here to tell us why we ought to go ahead and permit the phase II rule to go into effect. In other words, to argue against the resolution of disapproval. For instance, if this were a hearing where the Federal Trade Commission had recently issued some new rulings with respect to advertising aimed at small children, I suspect that the Chairman of the FTC and his associates would be here giving us all the reasons why their particular new ruling ought to have the force of law.

And yet, I am surprised to find that the attitude, both in the comments of the chairman and the response to questions, and in the written testimony itself, is, really, in totality, a request that we vote in favor of the resolution of disapproval.

So, would you please explain to me why you are in effect asking us to reject what you have done?

Mr. **Curtis**. Well, without accepting the characterization, let me explain why the Commission is not here collectively or individually arguing that phase II be permitted to take effect.

Different from what you might expect under normal circumstances, the Commission is not exercising discretion in the phase II rulemaking, at least not exercising it in determining whether to go forward with it at this time.

I think that the Commission has viewed its responsibility as one of carrying out a directive of the Congress which Congress must then review from the standpoint of current market circumstances. We were directed to do so by statute by May 9, 1980, and we viewed it as our responsibility to present a rule which carries out the discernible congressional purposes.

Now, that does not mean that we individually, were it entirely a matter for our discretion, would have either presented this rule, or this rule at this time. I think what you are hearing from our side is an attempt to recognize that whether phase II goes into effect or not is largely a social judgment that is more properly a judgment for the Congress to make, rather than this Commission.

In addition, we are attempting, on a rather straightforward basis, to inform the subcommittee that there are significant problems with implementing this rule under this statutory schedule and within the confines of the statute that has been presented to us. Therefore, we have a certain lack of enthusiasm for it, if that is a fair judgment.

Mr. SHARP. Will the gentleman yield?

Mr. CORCORAN. I will yield in just a moment to my friend and colleague from Indiana.

I question the very basis of your presentation today because it is my understanding of our recent history that the Congress has attempted to take the difficult political questions and give those issues to nonpolitical agencies, such as FERC and your predecessor agency, to take it out of the realm of politics, especially when economic questions are involved, and give it to the experts to decide.

Now, I question that, as a matter of fact. I happen to question the Natural Gas Policy Act. I happen to question and, as one of the first cosponsors of H.R. 5862, would support the outright repeal of incremental pricing. But the point is that under the law, and under the concept of a legislative veto, the authority that we have is simply to act as a Governor on you, whereas, what you are in effect doing here today is telling us that we have made a decision on phase II rules; second, we do not think that the justification is all that persuasive at the moment. We allow it to your political judgment, to your social judgment as to what you want to do.

I think you are inviting us to disapprove that. Now, maybe you are doing that because you think the facts suggest that. Maybe you are doing that because you want to maintain the basic law itself. I just do not know what the rationale is. I would like to find out.

Mr. CURTIS. Let me make a couple of comments. There are two phases to incremental pricing. Under phase I, the Congress clearly spelled out its requirements and delegated full responsibility for implementation to the Commission. That has been put into effect.

There is no "reservation" with respect to phase I. The Congress did reserve in phase II the opportunity to review an extension of incremental pricing and, in my opinion, reserved the political judgment to itself, rather than assign it to the Commission. I believe that the Congress cannot have it both ways. It cannot reserve that judgement to itself through the veto authority and then assert that it should have been exercised independently by the agency, free fom congressional review or, more importantly, responsibility.

In my opinion, Congress has reserved the authority and should accept the responsibility for it.

Mr. CORCORAN. Well, I think it depends on your view of a legislative veto. I promised my friend from Indiana that I would yield, and I do now.

Mr. SHARP. Well, I was going to say, the gentleman is correct, very commonly we use the legislative veto as a technique of check on the agencies. However, I think it was very clear in the discussions—and I was a member of the negotiating team on the natural gas bill—that one of the chief reasons for utilization of the legislative veto here was very clearly to give Congress a second look at this policy before it would take effect, precisely because the incremental pricing section of the bill was in fact probably the least considered section of the entire act; it got very little attention in the House of Representatives because a version of it was in all the disputed alternatives that Members voted on. Second, we recognized very clearly that we lacked end-use data, and we lacked the knowledge of how it would impact differentially from distributing company to distributing company, pipeline to pipeline. Therefore, very clearly, we wanted a second shot at it to determine whether or not the policy should go ahead after we had seen at least some real world rule that people would have to live with.

So, I think in this case the Commission is not, I think, to blame at all; it is to be complimented that they have taken seriously the focus that I believe was the intent of Congress in the development of this issue.

Mr. DINGELL. The time of the gentleman has expired. The Chair recognizes the gentleman from Massachusetts, Mr. Markey.

Mr. MARKEY. Thank you, Mr. Chairman.

I am really torn on this question because there is a real superficial attractiveness to this phase II proposal which would shift the burden off of the residential sector and onto the industrial, affording some measure of protection to the consumer, to the homeowner and renter. This has an appeal to me.

On the other hand, when this deal was cut back in 1978 the intrastate natural gas was excluded. We know that every time we load up the industrial sector in the interstate market, we are increasing the economic competitive advantage that the intrastate market gas users have over the interstate gas market users.

So, when you exclude that sector, what you have is an incremental burden added on to the industrial sector of the interstate market.

I guess what my problem is in trying to decide—it is almost a Hobson's choice—is that the whole policy is flawed from the start that we never should have allowed for that distinction between the intrastate and interstate market. Mr. Curtis, if you could address the issue of the initial political compromise that was worked out with Russell Long back in 1978, and whether or not you think that was a policy that should have been included in the bill that now gives us this choice which, for me, forces me to choose between two sectors of my constituency, neither of which I particularly want to have to choose between at this point. I do not feel I should have to choose. Could you address that question?

Mr. CURTIS. Well, Mr. Markey, I think you point out a significant concern that one who is dependent upon the economic base being fed by the interstate system should worry about in imposing, artificially imposing, additional costs on industrial users to the benefit of the residential or high priority users. In incremental pricing you have the ability to affect only half of the market in the way that the regulatory system prior to 1978 had the ability to affect only half of the market in terms of producer sales.

So, that limitation on authority makes the exercise of incremental pricing all the more difficult and adds to what I call the riddle in determining which way to go in the exercise of judgment on the phase II rulemaking.

I think the Natural Gas Policy Act, as I have said on a couple occasions, combined in the words of the Christmas carol "The hopes and fears of all the years" on natural gas to date.

Yet, quite obviously, it is an act formed by compromise. It has many imperfections as a result, and if there were independent license to change the act I would guess that each member of this subcommittee and each member of my Commission would have a different solution.

With all of its imperfections, I think the Natural Gas Policy Act has worked at least to break down the jurisdictional barriers between the markets. It has also very much improved supply reliability for the interstate markets beyond what was possible to achieve under the previously existing regulatory scheme.

Mr. MARKEY. I appreciate that bubble that was created about a week after we passed the bill, and the overdeliverability situation which continues, and we appreciate the real significant impact it had upon the drilling that occurred in that week to begin to produce all that additional natural gas.

What I am wondering about, though, is you seem to be appearing here somehow in a perfunctory manner, that you are halfhearted. You have to abide by the law and you are now complying with it, and yet, you do not seem to have your heart in it at all.

I am wondering whether or not you could characterize that compromise that was conceived and ultimately carried out in 1978 which led to this disparity between the intrastate and the interstate market, your own personal opinion.

Mr. CURTIS. My own personal view is that the previously existing regulatory scheme posed substantial problems in terms of the interstate market's ability to obtain access to onshore production and in terms of the Commission's practical ability to provide more realistic price incentives for domestic production of natural gas.

The Natural Gas Policy Act changed that course, in my opinion, positively. Through 1979 we have seen significant increased drilling activity and new well completions in both natural gas development and exploratory wells. The interstate markets have been able to get hold of something on the order of 8 percent additional supplies. So, to that extent, the Natural Gas Policy Act represents a significant improvement over what was.

I think almost anyone would agree that it was not the optimal result, no matter what side of the policy debate they may be on.

Mr. MARKEY. But if you had to pull off just this one component of the overall bill that was drafted, even though there might have been some improvement in the production capacity of the industry and you were going to look at it for imperfections, would this have been one of the areas, the intrastate-interstate differential?

Mr. CURTIS. Yes, sir.

Mr. MARKEY. It would have been. Thank you.

Mr. DINGELL. The time of the gentleman has expired. The Chair recognizes now the gentleman from Washington, Mr. Swift.

Mr. BROWN. Mr. Chairman, if I can make an observation. I was going to ask Mr. Markey, but his time expired.

It occurs to me that the Natural Gas Policy Act was more a product of incest than it was of immaculate conception. The analogy about the hopes and fears left me with that.

Mr. Markey. More like—if I might add—the "immaculate deception."

Everyone leaves it with clean hands, but one way or the other, somehow or the other, a product is the result of the whole enterprise.

Mr. Swift. Now, how am I going to top that, Mr. Chairman? I yield back the balance of my time.

Mr. Dingell. The Chair thanks the gentleman. The Chair recognizes now the gentleman from Colorado, Mr. Wirth.

Mr. Wirth. Thank you, Mr. Chairman.

If I could just review very quickly with you, Mr. Curtis, the reasons we got into this; it is well laid out in your testimony. We have two thrusts, one was market ordering and the other was the equity issue; right?

Mr. Curtis. Yes.

Mr. Wirth. Is it the considered opinion of all of you who have been struggling with this issue that the market ordering function is not achieved under this rule?

Mr. Curtis. Not on phase II. I think it has some opportunity to work with respect to the industrial boiler fuel users who do effectively have alternative fuel capabilities and will switch to those alternatives should their delivered price of natural gas get above the prices of alternative fuels available to them.

Now, unfortunately that alternative is primarily oil—I say "unfortunately" because to the extent that market ordering works and switching occurs at the margin, we may in the transition add to our fuel oil demand.

Mr. Wirth. So we are therefore left in this discussion as to whether or not incremental pricing as proposed under phase II meets the test of equity or price shielding.

Mr. Curtis. That is correct. On phase II, we believe that the only issue before the Congress is whether the shielding benefit should be pursued and phase II be put into effect for its shielding purpose.

Mr. Wirth. And your projections are, the benefits we sought to provide for Presidential consumers would, in 1980, be only between $20 and $25 per household per year?

Mr. Curtis. Well, actually our projections are now less than that. We have included an analysis which makes various assumptions, but phase II itself is only worth, by our estimate, $10 per household per year if one assumes that the average household takes 130 Mcf per year.

The reason for that is, by stopping incremental pricing at the high sulfur No. 6 cost because of a concern with the disruptive problems with the industrial base, we have a benefit for the remaining exempt users, the so-called high priority users, that is lessened by that decision and then spread over a very large base. What we are doing is focusing the burden on roughly 15 to 25 percent of users for the benefit of 75 to 85 percent.

Mr. Wirth. FERC is not authorized under the act to target those benefits to low-income households. Is that correct?

Mr. Curtis. Exactly.

Mr. Wirth. A lot of us are very concerned about the potential of the impact of deregulation, or phased deregulation, on low-income households, where there is less discretionary income to offset rising energy prices with the conservation investments possible for middle- and upper-income homes. Would your assessment of the rule be different in this respect if you were proposing phase II in 1984? What is your guess as to what the benefit would be per household at that point?

Mr. Curtis. Let me again emphasize that here I am speaking individually. I think that those concerns are substantial with respect to the price impacts on the low income, fixed income, and the poor. I do not think that incremental pricing in its extension under phase II, or under phase I because of the narrowness of its base, provides an effective tool for dealing with those social concerns. I think the Congres has to find another mechanism for confronting those needs. Incremental pricing is simply too indirect a mechanism for getting at it, in my judgment.

Mr. Wirth. Thank you, Mr. Chairman.

Mr. Dingell. The time of the gentleman has expired, the Chair recognizes the gentleman from Texas, Mr. Leland, for 5 minutes.

Mr. Leland. Thank you, Mr. Chairman, no questions.

Mr. Dingell. The Chair thanks the gentleman. The Chair recognizes the gentleman from Texas, Mr. Collins.

Mr. Collins. Mr. Chairman, I noticed that you made a statement about alternative fuel, that if the price of gas changed it would not take much to push these industrial users above the line, precipitating a switch to other fuels. Is that desirable? Is there anything undesirable about switching to other fuels?

Mr. Curtis. It depends on what your objectives are, Mr. Collins. If there is to be some discipline on the purchase decisions, at the margin of use, then you have to risk and indeed experience some industrial load loss for that discipline to effectively govern the purchase decisions on gas. But the price for doing so, as your question points out, may be to add to demand for fuel oil, at least in a transitional period. Considering that at least in liquids markets—and this is what we are talking about here, liquids—we are more than 50 percent dependent on imports, you might raise significant energy policy concern with that result, should it occur.

Mr. Collins. When I read this, Mr. Curtis, I was thinking about how this country got into oil and gas. It was when the people in Massachusetts, who owned all the whale ships in this country, raised the price of whale oil so high that they started looking for alternatives; that is the actual history of it. They had the only fuel which we were using—whale oil. When it got too high, that fellow up in Titusville, Pa.—you remember the history of it—he found that seepage. That started oil, and after that they began the oil and gas industry.

So, sometimes the way to push us into good alternatives would be to let the price rise to stimulate industry. Now, we have a real problem with gas. Do you not use the 6-to-1 ratio in terms of oil on gas in Btu?

Mr. Curtis. Approximately, 5.8 to 1.

Mr. Collins. That is right. So, what we are saying is, if gas is selling at one price, then oil ought to be selling six times as high. Well, now, with oil selling around $30 a barrel and with gas selling at $2.50 an Mcf, we have a mixed up situation in the economy. We are putting tremendous pressure on buying gas because 6 to 1 would be $15, whereas the market is $30; which means gas must be the biggest bargain on the market today. Is that right?

Mr. Curtis. Gas is certainly priced below its commodity value. That results from a number of things. At least in part from a historical mechanism for regulating the gas industry. Another is, at least in part, the result of the way this industry developed in the first place. But it is priced significantly below its commodity value.

Mr. Collins. In a fair economic market today it probably would be better if it were priced at $5. Do you see any damage to the economy, from the complete energy picture, if we would let the price of gas go to $5, where it should be?

Mr. Curtis. During the Commission's deliberations over incremental pricing, one of the alternatives was to peg the delivered price to industrial users to the No. 2 home heating oil, distillate price, which is roughly $5.50 per million Btu's. That would be a fair price at the moment.

We learned, and the Commission accepted, that that would create substantial problems for the industrial sector because it would raise their delivered prices about $2.80 a million Btu's—which is their current delivered price on average—to $5.50 or above in a very short time. It is a transitional problem that affected industry more than anything else.

Mr. Collins. Let me interrupt you just a minute, now. We buy it from Canada today at $4.47, I think.

Mr. Curtis. Yes, sir, at the border.

Mr. Collins. Then we went back and told Mexico that we traded with them too cheap. We were trading with them at $2.50. Now, we are paying them, about $4.47. Why should not the United States, right in the middle, pay the same price as they are paying to Canada and to Mexico?

Mr. Curtis. That is a question, as you know, Mr. Collins, that was raised during the Natural Gas Policy Act debate. It is a basic policy question that the Congress has considered before and, I am sure, worries about from time to time. I would rather not express an opinion on it right now.

Mr. Collins. Thank you, Mr. Chairman.

Mr. Dingell. The time of the gentleman has expired. The Chair recognizes the gentleman from New Jersey, Mr. Maguire.

Mr. Maguire. No, thank you, Mr. Chairman.

Mr. Dingell. Mr. Chairman and members of the Commission, the subcommittee thanks you for your assistance to us, your patience, and your very helpful testimony.

Mr. Wirth. Mr. Chairman?

Mr. Dingell. Who seeks recognition? The gentleman from Colorado.

Mr. Wirth. Mr. Chairman, would it be possible for me to take another 90 seconds of Chairman Curtis' time on this?

Mr. Dingell. The Chair recognizes the gentleman for that purpose.

Mr. Wirth. Thank you, Mr. Chairman.

I was intrigued, Mr. Chairman, with your comments at the end of my questioning, that in your personal opinion, you did not think that the phase II rule was an effective instrument for the equity or price shielding goals that I think probably most on the subcommit-

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tee share. If, in fact, this is not the way to accomplish these goals, what would you put in place of incremental pricing? What are the options that we face in terms of the residential and small commercial price protection devices that we are all concerned about?

Mr. CURTIS. It is something that obviously deserves a more considered response than I could give you in this context.

Mr. WIRTH. I understand.

Mr. CURTIS. Let me only say that sheltering from increased energy prices is a pervasive need that stretches across all fuel forms. Indeed, the call for a response to those concerns is even louder in oil pricing and for those who are dependent upon electricity for their space heating requirements. But it is one that can also be felt not only in natural gas but in coal because all prices are being heaved upward in relationship to the oil prices at the world level. That is reality. That is something that we, as a society, have to face.

But we have to, at the same time, recognize that there are sectors of our society less able to invest in the future or share in that reality. They need some transitional protection.

Now, maybe it is because I have less experience with the tax code that it seems to me that the tax code provides the best opportunity for reflecting those social concerns by an adjustment to the graduated income tax and perhaps even through a negative income tax device.

I think one may also look at the decision to separately fund social security taxes at the same time that these large transitional problems are going through society.

In short, I think it takes a comprehensive look at the full welfare package as well as tax policy to address this question. But I think it is important to recognize the limits of energy policy, particularly energy policy as it is focused on a particular industry, only one part of the energy matrix, in any attempt to accomplish that social goal. I think that is misplaced.

Mr. WIRTH. Thank you, Mr. Chairman.

Mr. DINGELL. The time of the gentleman has expired.

Mr. Chairman and members of the Commission, the subcommittee does thank you for your patience and your assistance to us, and we now excuse you with our gratitude for both your appearance today and for a job well done in terms of complying with the congressional mandate on the incremental pricing provisions of phase II. We thank you all.

Mr. CURTIS. Thank you, Mr. Chairman.

[Whereupon, at 3:35 p.m., the hearing adjourned.]

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